

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

BRIEF FOR PETITIONER.

IN THE

United States Court of Appeals

For the District of Columbia Circuit.
FOR THE DISTRICT OF COLUMBIA CIRCUIT.

FILED

MAY 2 1960

No. 15461.

261

Joseph W. Stewart

PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent,

TEXAS GAS TRANSMISSION CORPORATION, et al.,
Intervenor-Respondents.

ON PETITION FOR REVIEW OF AN ORDER OF THE
FEDERAL POWER COMMISSION.

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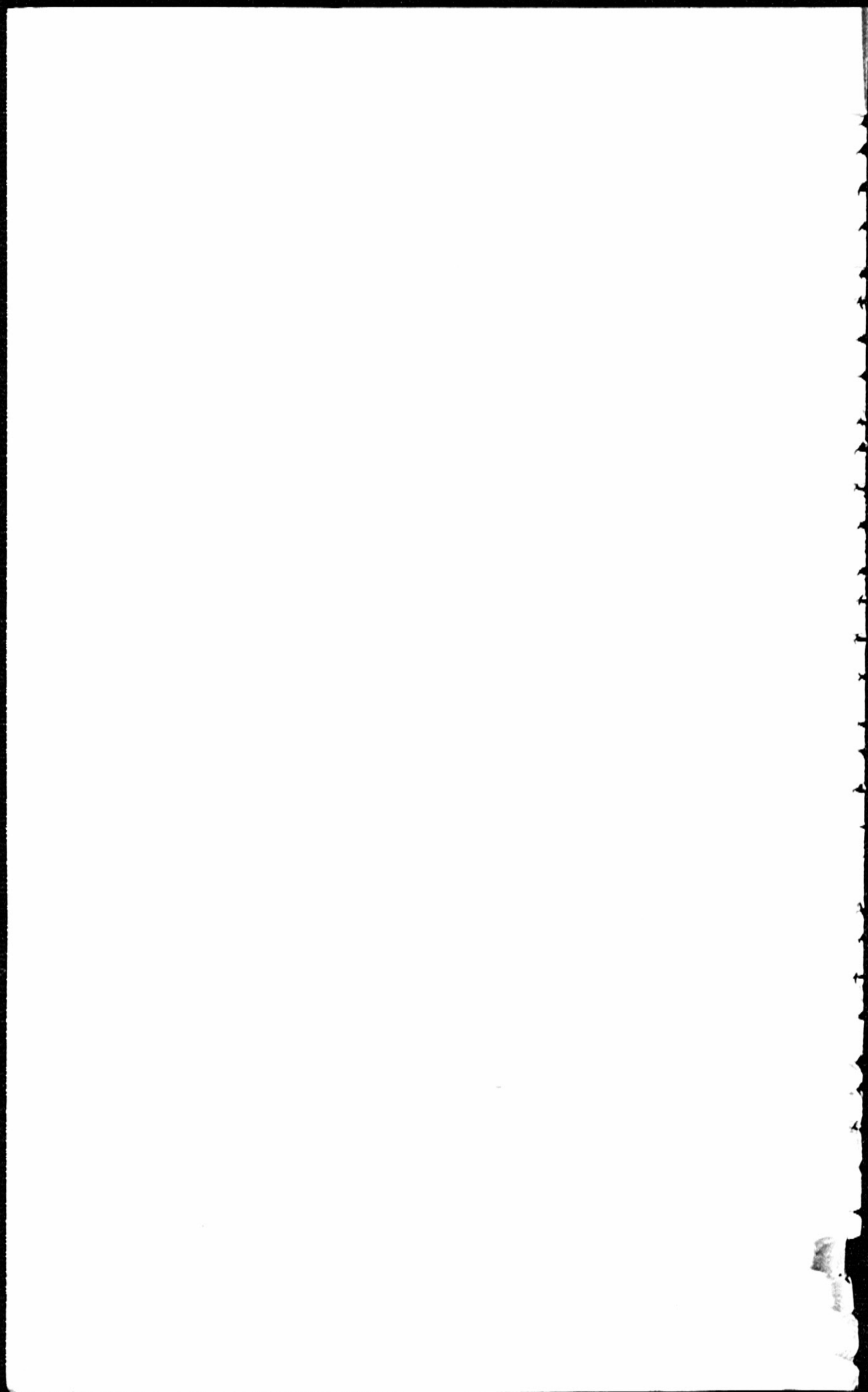


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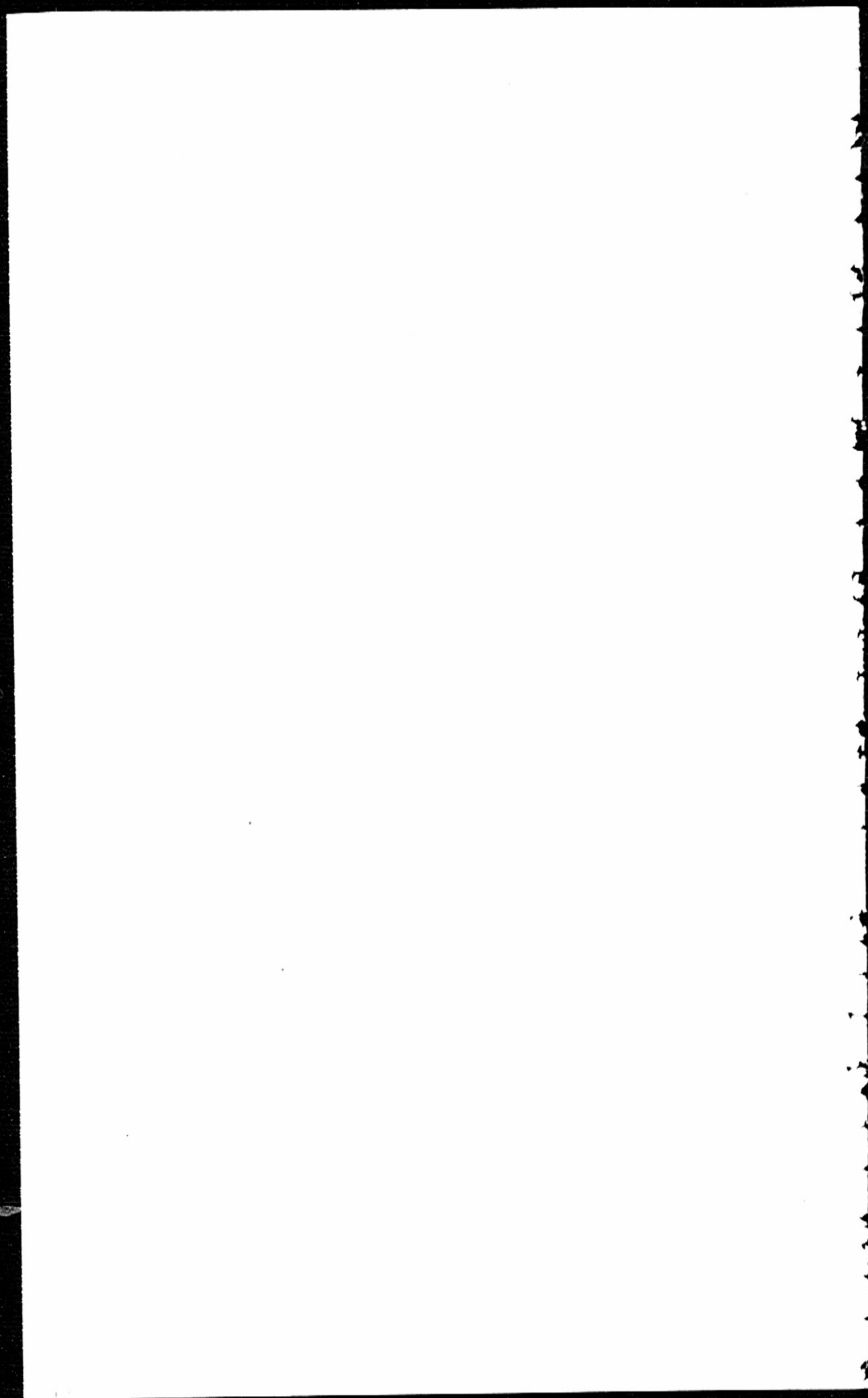
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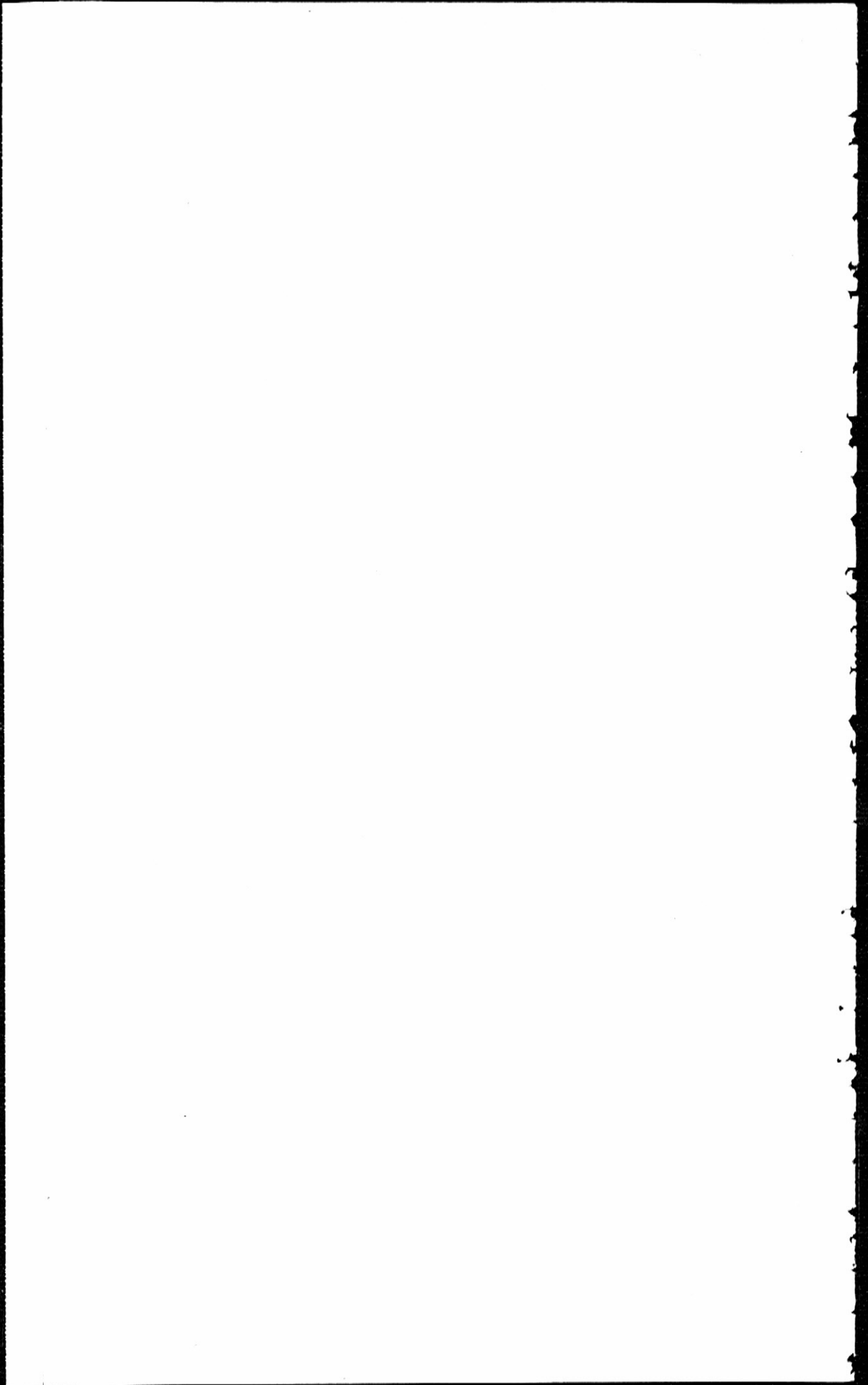
Statement of Questions Presented.

1. Is not respondent Federal Power Commission's final determination in this proceeding erroneous and unlawful in the light of the decisions of the Supreme Court of the United States in

(a) *Atlantic Rfg. Co. v. Pub. Serv. Comm'n.*, 360 U. S. 378 (June 22, 1959), affirming, on different grounds *Public Service Com'n. of N. Y. v. Federal Power Com'n.*, 257 F. 2d 717 (3rd Cir., June 30, 1958)—commonly denominated "*Catco*", and

(b) *Pub. Serv. Comm'n of N. Y. v. F. P. C.*, 361 U. S. 195 (December 14, 1959) summarily vacating *United Gas Improvement Co. v. Federal Power Com'n.*, 269 F. 2d 865 (3rd Cir., August 4, 1959)—commonly denominated "*Transco-Seaboard*"?

2. Was there substantial competent evidence in the record to support respondent's findings or determinations (a) that the producer-applicants' proposed initial prices were not "out of line", (b) that the sales at these prices would not elevate the purchased gas costs of the purchaser and the purchaser's distribution-company customers, and (c) that the issuance of permanent unconditional certificates of public convenience and necessity to the producer-applicants for sales at their proposed initial prices would be in the public interest?



IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT.

No. 15461.

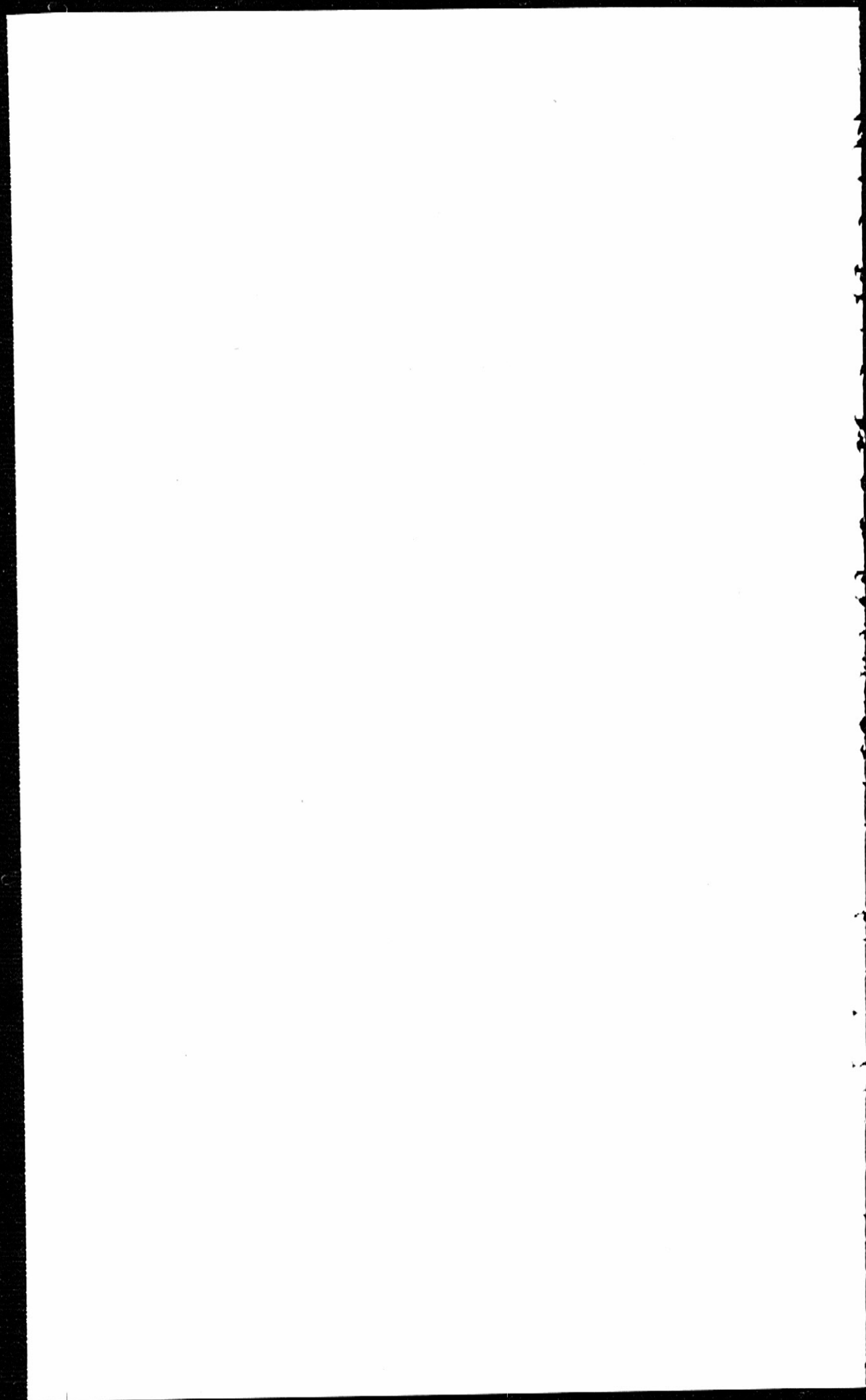
PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent,

TEXAS GAS TRANSMISSION CORPORATION, TEXAS EASTERN
TRANSMISSION CORPORATION, HOPE NATURAL GAS COMPANY,
TEXAS GAS EXPLORATION CORPORATION, J. RAY McDERMOTT
& Co., INC., KILBOY PROPERTIES INCORPORATED, THE
CALIFORNIA COMPANY, CALLERY PROPERTIES, INC., OCEAN
DRILLING & EXPLORATION COMPANY, HUMBLE OIL & REFIN-
ING COMPANY, AMERADA PETROLEUM CORPORATION, KERR-
McGEE OIL INDUSTRIES, INC., BEL OIL CORPORATION,
CAROLINE HUNT SANDS AND LOYD B. SANDS, RICHARDSON
& BASS (LOUISIANA ACCOUNT), OPERATOR, MAGNOLIA PETRO-
LEUM COMPANY, BECK OIL COMPANY, PHILLIPS PETROLEUM
COMPANY, MISSISSIPPI RIVER FUEL CORPORATION, UNION
OIL COMPANY OF CALIFORNIA, TIDEWATER OIL COMPANY,
CONTINENTAL OIL COMPANY, SHELL OIL COMPANY, PAN
AMERICAN PETROLEUM CORPORATION,

Intervenor-Respondents.



Jurisdictional Statement.

This is a proceeding to review an opinion and final order of the Federal Power Commission (FPC), issued in a consolidated proceeding below instituted under Section 7 of the Natural Gas Act. Therein respondent FPC granted unconditional certificates of public convenience and necessity to twenty-one producers of natural gas from fields in southern Louisiana, authorizing them to make new sales in interstate commerce to a natural-gas wholesale distribution company (Hope) at initial prices which were (a) "out of line" and (b) unsupported by evidence of the public convenience and necessity therein and therefor.

The Court has jurisdiction to review the opinion and order under the provisions of Section 19(b) of the Natural Gas Act, 52 Stat. 831 (1938), as amended, 72 Stat. 941 (1958), 15 U. S. C. §717r(b) (1958). The opinion and order under review were issued by the respondent Commission on August 10, 1959 (R. 4724-39). The New York Public Service Commission (PSC), a party below and petitioner herein, filed an application for rehearing thereof on September 8, 1959 (R. 4747-59). The order denying rehearing was issued on October 7, 1959 (R. 4766-67). The Petition for Review was filed in this Court on December 4, 1959.

Statement of the Case.

The Applications.

The consolidated proceedings below involved 29 related applications to the FPC for certificates of public convenience and necessity under Section 7(c) of the Natural Gas Act.¹ Twenty-one natural gas producers (producer-appli-

¹ The three pipeline transportation-distribution applications (not here in contest *per se*) were: *Texas Gas Transmission Corporation*, Doc. No. G-17335; *Texas Eastern Transmission Corporation*, Doc. No. G-17420; and *Hope Natural Gas Company*, Doc. No. G-17565. The twenty-six producer-sale certifications which are here under review were granted in: *Texas Gas Exploration Corporation*, Doc. No. G-17336; *J. Ray McDermott & Co., Inc.*, Doc. No. G-17337; *Kilroy Properties Incorporated, et al.*, Doc. No. G-17338; *The California Company*, Doc. No. G-17339; *Callery Prop-*

cants) sought certificates for a total of 26 natural gas sales from fields in and offshore the coast of southern Louisiana to Hope Natural Gas Company (Hope), pursuant to a contract or contracts between each seller and Hope.

Hope, the purchaser, requested a certificate to establish new delivery points to its existing, affiliated, wholesale customers in the northeast and to sell and deliver to those customers the gas it proposed to acquire from the producer-applicants in Louisiana, plus a small additional quantity it proposed to produce itself on its own gas properties in the southwest.

Two major interstate pipeline companies, Texas Gas Transmission Corporation (Texas Gas) and Texas Eastern Transmission Corporation (Texas Eastern) sought certificates authorizing their construction of certain additional transmission facilities and their transportation of the gas for Hope from the producing area in the Gulf Coast region of Louisiana to Ohio (Texas Gas) and thence to the delivery points on Hope's system in West Virginia (Texas Eastern).

The gas acquisitions.

Hope is a subsidiary of the Consolidated Natural Gas Company, a public utility holding company parent of an integrated natural gas system. The Consolidated System, through its several subsidiaries, engages in the production, purchase, transmission and wholesale and retail distribution of natural gas. It renders gas service directly and indirectly, through sales to other distribution companies,

erties, Inc., Doc. Nos. G-17340 & 17341; *Ocean Drilling & Exploration Company*, Doc. Nos. G-17342 & 17343; *Humble Oil & Refining Company*, Doc. No. G-17391; *Amerada Petroleum Corporation*, Doc. Nos. G-17393 & 17407; *Kerr-McGee Oil Industries, Inc.*, Doc. No. 17396; *Bel Oil Corporation*, Doc. No. G-17397; *Caroline Hunt Sands and Loyd B. Sands*, Doc. No. G-17398; *Richardson & Bass (Louisiana Account), Operator*, Doc. No. G-17399; *Magnolia Petroleum Company*, Doc. No. G-17401; *Beck Oil Company, et al.*, Doc. No. G-17402; *Phillips Petroleum Company*, Doc. No. G-17405; *Mississippi River Fuel Corporation*, Doc. No. G-17413; *Union Oil Company of California*, Doc. No. G-17457; *Tidewater Oil Company*, Doc. Nos. G-17463, 17474, 17475 & 17483; *Continental Oil Company*, Doc. Nos. G-17554 & 17566; *Shell Oil Company*, Doc. No. G-17560; *Pan American Petroleum Corporation*, Doc. No. G-17574.

to many communities in the states of New York, Ohio, Pennsylvania and West Virginia. Hope is the System's largest producer and purchaser of natural gas. Prior to the instant transactions, approximately 70% of the System's total natural gas supply was purchased at northern delivery points, at an approximate average price of 37.5¢ per Mcf, from three major transcontinental pipeline companies—Tennessee Gas Transmission Company (Tennessee), Panhandle Eastern Pipe Line Company (Panhandle), and Texas Eastern, one of the two transporter-applicants in this proceeding. The balance of its gas supply was obtained from sources in the Appalachian area at a price of approximately 24.05¢ per Mcf (R. 1178-80, 1181, 1559-61). The proposal in this proceeding marked its first effort to purchase gas directly from southwestern producers.

The proposed charges by Texas Gas and Texas Eastern for transporting the gas for Hope were, respectively, 17.3¢ (Louisiana to Ohio-Texas Gas) and 4.5¢ (Ohio to West Virginia-Texas Eastern) per Mcf, for a total transportation cost of 21.8¢ per Mcf (R. 4332-34 [Item EE]).

The 26 gas sale and purchase contracts between Hope and its proposed producer-suppliers were substantially identical, except for differences in volume and for two variations in price provisions. In total, the proposed sales involved approximately 36.5 billion cubic feet of natural gas per annum. Twenty-two of the contracts, covering approximately 95% of the gas to be sold, provided for initial prices of 23.55¢ per Mcf. The remaining four contracts, covering the other 5% of the gas to be sold, provided for initial prices of 23.05¢ per Mcf. In addition, all of the contracts contained clauses calling for periodic, automatic price increases of 1¢ per Mcf every 4 years and for complete redetermination of price, after an 8 or 12-year period, upon the average of the highest prices then being paid under other gas sale and purchase contracts in the area (R. 1827-28 [Ex. 6, pp. 1-2], 1166-70).

The gas purchase contracts—at the 23.05¢ and 23.55¢ per Mcf initial price levels—were consummated between August and December, 1958. Thus, their negotiation and

execution occurred at the high point of the 2-year period (June, 1957 to June, 1959) which was dominated by respondent's post-Catco, laissez-faire producer initial pricing philosophy.² They coincided with

1. respondent's unconditional certification, on September 4, 1958, of 39 sales to Transcontinental Gas Pipe Line Corporation in the same producing area at initial prices of 22.4¢ to 23.3¢ per Mcf—the *Transco-Seaboard* certification which was summarily upset and remanded by the Supreme Court on December 14, 1959;

2. the execution, during the summer of 1958, of 7 gas sale and purchase contracts by Trunkline Gas Company in the same producing area at initial prices of 24.05¢ and respondent's certification thereof, almost on the eve of this proceeding, on May 22, 1959;³ and

3. the execution, and virtually automatic certification by respondent, of numerous other gas sale and purchase contracts in the same producing area at initial prices of 22.4¢ per Mcf and above—all upon the strength of and in reliance upon its June, 1957, Catco 22.4¢ precedent which the Supreme Court condemned and rescinded on June 22, 1959.

Of the 21 sellers who were producer-applicants in this proceeding no less than 9 (Amerada, Humble, Union, Continental, Magnolia, Phillips, Pan American, Tidewater, and California) had also been applicants in the *Catco*, *Transco-Seaboard* or *Trunkline* cases and thus already had obtained certificates from respondent for sales at initial prices ranging from 22.4¢ to 24.05¢ per Mcf—developments of which the remaining 12 were keenly aware. Such was the

² *Infra* pp. 18-20.

³ *Trunkline Gas Co., et al.*, Doc. Nos. G-15374, *et al.*, Opinion No. 321, 21 F. P. C. 704, May 22, 1959, review of which is pending in this Court, *Public Service Commission of New York v. Federal Power Commission*, CADC No. 15365.

producer initial price climate and background of Hope's 1958 entry into the southern Louisiana gas market and of the subsequent unconditional FPC certification of its efforts.

The Hearings.

Hearings in the consolidated proceedings below were held from June 10 to June 22 and on June 25, 1959. Hope and its affiliated customers introduced evidence to show, among other things, that estimated consumer gas demands in succeeding years exceeded the supply presently under contract to the Consolidated System. Their witnesses testified that the System considered it desirable, for various reasons, to augment its existing supply by the method here proposed—i.e., Hope's direct purchase from natural gas producers, with the gas to be transported by the two pipeline applicants for Hope's account, at a delivered cost of some 45.325¢ per Mcf (R. 3220 [Ex. 13, p. 2], 1182-86).

The pipeline-applicants introduced evidence to support their proposed transportation charges.

Witnesses for the producer-applicants testified that the initial price provisions of the contracts between their companies and Hope were the product of arm's-length negotiation. A few proffered the additional information—only too well-known to everyone acquainted with post-Catco southern Louisiana initial price conditions—that similar prices had been offered by others for the supplies involved in this proceeding, or that similar prices were being received by themselves or by other producers under other recently executed southern Louisiana gas sale contracts.⁴ Some of the applicants frankly admitted the latter factor had predetermined their initial price floor in embarking on negotiations with Hope (R. 383, 499, 507). Hope's witness, who had negotiated the purchases, emphatically corroborated this fact.

⁴ R. 36, 93, 115, 119, 156, 180, 207, 226-27, 230, 237, 243, 254, 275, 290, 307, 337, 340-41, 349, 365, 380, 393, 407, 409-14, 449-50, 454-55, 458-59, 501, 525.

"I would like to say about the second or third day of June we started operating to try to purchase gas in the South Louisiana area to acquire an amount of about 100 million a day and after traveling around and calling on any number of people and discussing contracts with them and after having been in the territory for two and a half years I knew that the prices under which contracts were being purchased were from 17 cents to 25 cents and I called on in total about fifty companies and after calling on about ten and getting very cold shouldered without mentioning any price at all, because I did not want to get thrown out the door and I wanted to stay in if I could, and I called on the Spur (Superior?) Oil Company and they told me that they just could not discuss it because they sold their gas right at that time at 21.5 cents.⁵

"I called on several other people who were dealing with trunk lines (Trunkline?) and they were getting 22 cents.⁵ After calling on the biggest purchaser that we made there three times I offered him 21 and a half cents"⁵ (R. 1232; ftsns. supplied).

The Commission's Opinion No. 327.

Upon motion by Hope, the Commission waived the intermediate decision [by the Presiding Examiner] procedure in this case. Its Opinion No. 327 and accompanying order were issued on August 10, 1959, little more than a month after the Supreme Court's opinion in the *Catco* case and—much more significantly—6 days after the Third Circuit's affirmance of other unconditional producer sale certifications by FPC, at similar initial prices, in the *Transco-Seaboard* case.

The opinion dealt separately with the Hope proposal, the Texas Gas and Texas Eastern proposals and with the producer applications. The Hope proposal was certificated without qualification. Because of certain objections to the transportation charges proposed by the two transmission companies, certificates of public convenience and necessity

⁵ Ex-tax.

issued to them were conditioned upon the filing by each of a satisfactory transportation rate schedule.⁶

The opinion then proceeded to consideration of the 23.05¢ and 23.55¢ per Mcf proposed producer initial prices. Although the Commission acknowledged its obligation to conduct its inquiry on that subject "in the light of the Catco decision" and, in fact, reported that it had "considered every element required or indicated by the (Supreme) Court", nevertheless it concluded that the proposed prices had been shown, on the record below, to be required by public convenience and necessity and that there was, therefore, no reason or occasion for the imposition of initial-price reducing conditions in this case. In support of this determination, the Commission found

(1) that—notwithstanding the Supreme Court's June 22 reversal of a group of 22.4¢ certifications as "out of line" with the predominant 17-18¢ southern Louisiana, non-suspect price level—on August 10 initial prices of 23.05¢ and 23.55¢ were not to be deemed "out of line" because they coincided in amount with (a) those the Supreme Court had before it, and (b) many others based thereupon which FPC had approved before the Supreme Court spoke;

(2) that in any event the location of the fields, the depth of the sands through which this gas was produced, and the general inflationary trend of costs over recent years somehow conferred an aura of propriety upon the proposed producer prices—without the necessity for (and despite the total absence of) record evidence showing the bearing or relationship, if any, of these or any other cost or revenue factors to the demanded prices; and

(3) that the purchases at these prices would not cause an "immediate" increase in Hope's rates to its

⁶ Texas Gas' subsequently filed rate schedule reduced its transportation charge from 17.3¢ to 16.8¢ per Mcf. Texas Eastern will submit a report on its transportation charge after the transportation service has been in effect for a full year.

customers, nor result in an increase in the weighted average cost of its purchased gas—this despite repeated past demonstrations that purchases of new high-price gas supplies *always* produce exactly those results as, indeed, they obviously and inevitably must, notwithstanding any and all *ad hoc* protestations to the contrary.

Thus did the Commission dispose of the objections of this petitioner and those of its own staff to continued unconditional certification of totally unjustified and unsupported, Catco-plus initial price levels in southern Louisiana. Thus was the Supreme Court's *Catco* opinion, as "considered" and "interpreted" by the Commission, found to *countenance* (!) the imbedding of 26 additional sales, at still unsubstantiated initial prices of 23¢ per Mcf and above, into the southern Louisiana price structure.

The only other guidance the Commission seemed to have extracted from the Supreme Court's decision was that it was no longer necessary for it to maintain the fiction of softening the impact of such unconditional certifications by instituting Section 5 investigations against the producers authorized to collect such charges. None were instituted with respect to those sanctioned in this proceeding.

On September 8, 1959, PSC applied for rehearing of Opinion No. 327 (R. 4747-59). Therein the multifarious errors in FPC's findings and rationale were plainly set forth. In its order denying that application, the Commission misconstrued the tenor of the PSC contentions and concluded as follows:

"We think, as the Court held in *United Gas Improvement Co. v. F. P. C.*, Nos. 12798 and 12805 (CA3, August 4, 1959), F. 2d (Transco-Seaboard), with respect to proposed producer prices somewhat comparable to those involved herein, that the balancing of the weight properly to be accorded the various factors of public convenience and necessity justified certifying the producer sales proposed herein without any price condition" (R. 4767).

The order was issued on October 7, 1959. Two days later, on October 9, 1959, PSC filed its petition for certiorari in the *Tranco-Seaboard* case. Two months later, on December 14, 1959, in the face of *precisely the same* arguments and rationale (erroneous interpretations of *Catco*, etc.) as are here advanced in support of the determination under review, the Supreme Court summarily vacated the judgment of the Third Circuit and remanded the *virtually identical*, similarly erroneous producer certifications there involved to the respondent for reconsideration and re-evaluation in the light of *Catco*.

Statement of Points Relied on by Petitioner.

1. The Commission erred in concluding, on the record in these proceedings, that the sales of the subject volumes of gas by the producer-applicants to Hope *at the proposed initial prices* are required by or consistent with the public convenience and necessity.

2. The Commission erred in issuing certificates to the producer-applicants without *either* imposing initial price conditions *or* requiring presentation of substantial, competent evidence to show their need for the price exacted and the relationship of their price proposals to the present or future public convenience and necessity.

3. The Commission erred in concluding that the contractual initial prices for the proposed sales were not "out of line" within the meaning of the Supreme Court's *Catco* decision.

4. The Commission erred in relying upon (a) other unwarranted and unjustified prices in the area, (b) generalized, inapposite economic data outside the record, and (c) unsupported speculation as to producer costs, both to sustain its conclusion that the contractual initial prices were not "out of line" and to offset the absence of evi-

dentiary support for its determination that public convenience and necessity required unconditional certification of the producer sales at the proposed prices.

Summary of Argument.

I. The propriety of the Commission's determination, opinion and order here under review, must be evaluated in the light of the two recent decisions by the Supreme Court of the United States (*Catco* and *Transco-Seaboard*) on the issue presented in this case. That issue—concerning the Commission's obligation, under Section 7 of the Natural Gas Act, with respect to high producer initial prices—has had a long, complex and controversial history. Petitioner believes that the Supreme Court decisions have provided a definitive resolution of the issue, one which mandates reversal of the present unconditional certification. However, it appears that the controversy is still not at an end. The present appeal is one of several which the respondent insists on pursuing—notwithstanding the Supreme Court's edicts—before this and other Courts involving its persistent unconditional certification, on deficient records, of *Catco-plus* initial prices.

[In an effort to assist the Court and to place the present case in proper context and perspective so that the pertinence and import of the high Court decisions may be more readily perceived, we respectfully beg leave to precede our argument with a brief chronology of the course of the FPC's regulation of producer natural gas sales in southern Louisiana to date, under (1) Section 7 and (2) Sections 4 and 5 of the Natural Gas Act—*infra*, p. 12].

II. The proposed producer initial price levels in this proceeding, uniformly higher than the *Catco* levels and, in most instances, higher than the maximum *Transco-Seaboard* levels, were justified by nothing other than the same type of evidence held inadequate to sustain unconditional certification of those two groups of sales—i.e., evidence of arm's-length negotiation, evidence of other sales in the

area at similar prices and evidence of the buyer's ability to sell more gas. Opinion No. 327 concludes that no other or better justification for the initial prices is necessary to sustain unconditional certification in this case.

The principal basis for this conclusion is the Commission's insistence that the present prices, although higher than *Catco's* and *Transco-Seaboard's*, are not "out of line" as the latter were found to be. This insistence the respondent would support (1) by reference to other of its recent high initial price certifications, all issued on the authority of its *Catco* and *Transco-Seaboard* decisions and all presently on appeal; and (2) by "consideration" of inflationary trends and other speculative "cost" factors, none of which are in this record and none of which—according to the applicants' testimony—played any part in the determination of the contractually fixed prices.

As further support for its decision to certificate these sales without *either* the price condition *or* the evidence of public convenience and necessity called for by the Supreme Court's *Catco* decision, Opinion No. 327 declares that the proposed prices will not "adversely affect" the consuming public and that "denial" of these supplies to Hope (by the imposition of price conditions) would be a "disservice" to that public.

The notion that high price gas purchases can continue to be sanctioned by the FPC without "adversely" affecting gas rates to the consuming public is illogical on its face and, in any event, has been discredited by repeated demonstrations to the contrary.

The Commission's tacit *assumption* (of *Catco*-threat provenance) that imposition of initial price conditions would result in "denial of these supplies to Hope" is unsupported (and unsupportable) and simply ignores the statutory requirement that *all* gas entering the interstate market, by *whomever* purchased, must enter on terms which the public convenience and necessity require—not those the seller would dictate. Were respondent to insist, *uniformly*, upon compliance with this statutory standard, the constant

producer threat of diversion of gas supplies from purchasers like Hope (whose certificate proceedings are afflicted with the intervention of those who insist upon FPC enforcement of the Natural Gas Act) to other purchasers (whose proceedings have been closed to this petitioner and other such advocates) could effectively be dispelled.

FPC REGULATION OF PRODUCER PRICES AND RATES IN SOUTHERN LOUISIANA—1954 TO DATE

A.

Initial Prices.

1. Natural Gas Act, Section 7.

Section 7 in pertinent part, provides:

“(c) No natural-gas company or person which will be a natural-gas company * * * shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, * * * unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations * * *” “(e) * * * a certificate shall be issued to any qualified applicant therefor, authorizing the * * * sale, * * * covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed * * * sale * * * to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.”

2. Pre-Phillips.

Before 1954, the epochal year in which the FPC was first apprised by the Supreme Court of the United States of its duty to regulate producer natural gas sales under the Natural Gas Act of 1938,⁷ the typical *unregulated* initial price of natural gas at the wellhead in the State of Louisiana was in the neighborhood of 9 to 10¢ per Mcf. Two of the pipelines now furnishing gas to the Consolidated System were then paying *maximum* initial prices, under their more recently executed gas purchase contracts, of 8.32¢ per Mcf (Tennessee Gas Transmission Corporation—Tennessee) and 9.0¢ per Mcf (United Gas Pipeline Company—United), plus 1¢ per Mcf for reimbursement of Louisiana taxes.⁸ Another important supplier of New York consumers (Transcontinental Gas Pipe Line Corporation—Transco) was paying 8.80¢ per Mcf plus 1¢ tax. Texas Gas, a transporter-applicant in the present proceeding, was paying 9¢ per Mcf plus 1¢ for its supplies. The combined purchases of these companies then (as now) accounted for in excess of 50% of all interstate sales in that state.

3. The Gulf Interstate and American Louisiana certifications—1953-54.

On the eve of the *Phillips* decision—while the Commission still proceeded under the erroneous belief that it lacked direct regulatory jurisdiction over producer sales—there occurred two portentous departures from these prevailing initial price levels. Two groups of sales were negotiated at initial prices ranging from 16¢ to 20¢ per Mcf. Both purchasers were “paper” pipelines—i.e., pipelines not yet in being. Because of their inferior bargaining position and because the FPC routinely required very large commitments of natural gas reserves as a prerequisite for new

⁷ *Phillips Petroleum Co. v. State of Wisconsin*, 347 U. S. 672.

⁸ Tennessee is a direct supplier of the Consolidated System. United is an indirect supplier, through sales to Texas Eastern. Neither Texas Eastern nor Panhandle, Consolidated's third direct supplier, were themselves purchasers in southern Louisiana at this period.

pipeline certifications, these companies were obliged to execute gas purchase contracts at levels far in excess of those in demand from other entrenched pipeline purchasers.

The FPC granted the pipeline certificates, but not without dissent and serious misgivings as to the potential effect of the producer initial price aspects of the transactions.⁹

In the latter respect the Commission was prescient, for with these two certifications the southern Louisiana producer price holocaust began. It has not since been halted, contained, abated or even markedly slowed down—at the hands of the respondent. It is this circumstance which accounts for our participation in *Catco* and *Transco-Seaboard* and our presence before this Court in this proceeding.

4. The Phillips decision—June 7, 1954.

On June 7, 1954, the Supreme Court plugged the legal gap through which the first (and most important) element of cost in the interstate acquisition, transmission and distribution of natural gas had theretofore been escaping effective regulatory control. Henceforth the producer sale itself was to be subject to the provisions and public interest standards of the Natural Gas Act, previously applied only at the second stage (pipeline sale) of the producer-to-consumer natural gas journey. Henceforth the Act was to apply (1) to existing producer rates (under Section 5 the Commission could investigate the charges being paid to determine their justness and reasonableness, or lack thereof); (2) to changes in existing producer rates (under Section 4 the producer would be obliged to establish the justness and reasonableness of any increase in an existing rate); and (3) to proposed producer initial prices for new interstate dedications or sales (under Section 7—it was thought—the producer would be obliged to demonstrate the public convenience and necessity of his proposed initial price or, failing that, to make his sale subject to consumer-protective initial price conditions).

⁹ *Matter of Gulf Interstate Gas Company*, Docket No. G-2058, Opinion 251, 12 F. P. C. 116, May 20, 1953; *Matter of American Louisiana Pipe Line Co.*, Docket No. G-2306, Opinion 276, 6 PUR 3d 476, October 1, 1954.

With *Phillips*, the power to condition *pipeline* certificates upon *pipeline* rate adjustments (a power repeatedly exercised by the FPC in pre-*Phillips* days¹⁰ although not, unfortunately, in the *Gulf Interstate* and *American Louisiana* certifications) ceased to be the only avenue of FPC control over the amounts paid producers for pipeline gas supplies.

5. Commission regulation of producer sales under Section 7—*Phillips* (June 7, 1954) to *Catco* (June 24, 1957).

As the Commission had anticipated—although to a far greater extent than it or anyone else had foreseen—the *Gulf Interstate* and *American Louisiana* pipeline certifications immediately began to wreak havoc with the southern Louisiana producer price structure, both as to existing prices and as to initial prices demanded for new gas. Existing prices soared upward per contractual “favored nation”, price redetermination and price renegotiation clauses—built-in price elevation provisions based on an “I-must-get-at-least-as-much-as-anybody-else-subsequently-gets” premise. This development called into play Commission producer rate regulation under Sections 4 and 5 of the Act. The effect and inconclusive (to date) result of this aspect of producer regulation is summarized *infra* B.

The *Gulf Interstate* and *American Louisiana* certifications also brought to an end producers’ satisfaction with the former typical 9 to 10¢ per Mcf level for initial prices for new sales. One by one most of the major pipelines purchasing in southern Louisiana were compelled to offer initial prices of 12 to 18¢ per Mcf to producers who were not going to be outdone, if they could help it, by their *Gulf Interstate* and *American Louisiana* supplier confreres. With Transco leading the way by increasing its initial pur-

¹⁰ See, e.g., *Michigan-Wisconsin Pipe Line Company*, 6 F. P. C. 1, 19-20 (1947); *aff’d sub nom. Panhandle Eastern Pipe Line Co. v. F. P. C.*, 83 App. D. C. 297, 169 F. 2d 881 (1948), *cert. denied*, 335 U. S. 854 (1948); *Alabama-Tennessee Natural Gas Co.*, 9 F. P. C. 461 and 849 (1950); 11 F. P. C. 75, 91, 114 (1952), *aff’d*, 203 F. 2d 494 (3rd Cir., 1953).

chase prices in one fell swoop from approximately 9.5¢ to 17¢ per Mcf; Tennessee increasing its offering prices to 18¢ per Mcf; United advancing its initial prices to 13.5¢ and Texas Gas outstripping the leaders by equaling the *Gulf Interstate* and *American Louisiana* maximums of 20¢ plus tax in a few of its new contracts, a 17 to 18¢ predominant initial price range soon came to supplant the 9 to 10¢ range as the typical level for new sales in southern Louisiana. This development called into play Commission regulation of producer sales under Section 7.

That enormous increases in initial prices were demanded by producers, under the inspiration of the *Gulf Interstate* and *American Louisiana* examples, was not surprising. That such increases were deemed acceptable to competitively-purchasing pipelines was equally understandable. For the latter (1) it was relatively simple to pass along increased purchased gas costs to their distribution-company customers and thence to ultimate consumers, and they did so promptly; and (2) expansion of sales and markets, at whatever increased cost to consumers, was the life-blood of their business. But that this process should be authorized, in each and every instance, by an utterly acquiescent FPC, almost automatically handing out unconditional certificates for any and every producer sale at any and every initial price demanded, all in complete contravention of the public convenience and necessity standard of Section 7, was a matter of vital concern and growing dismay to all segments of the distribution-consumption portions of the industry. Accordingly, consumer-representative intervenors urged, with uniform lack of success, that the FPC utilize its Section 7 initial price conditioning authority to stem initial price spirals, unless or until producers made some record demonstration, sometime—somewhere, of the propriety of or necessity for price increases of these proportions.¹¹

¹¹ See e. g., *Anthony J. Tamborello, et al.*, Doc. Nos. G-3045, *et al.*, Opinion Nos. 287, 11 PUR 3d 413 (1955) and 287-A, 15 F. P. C. 1 (1956) 12 PUR 3d 219 (1955); *Sinclair Oil and Gas Co., et al.*, Doc. No. G-9049, *et al.*, 15 F. P. C. 665 (1956) and *Atlantic Refining Co., et al.*, Doc. Nos. G-8809, *et al.*, 14 F. P. C. 408 (1955). The Commission issued scores of

No initial price conditions were imposed by the Commission. No demonstration of the propriety of or public convenience and necessity for the 17 to 18¢ initial price levels were called for or made by the producers. Instead, the requests of consumer-representative intervenors were met by still another upsurge of the initial price level in southern Louisiana, from 18¢ per Mcf by 1956 to 22.4¢ per Mcf or more in 1957 and thereafter. This one they set out to stop by judicial command.

6. The Catco certificates—June 24, 1957.

This upsurge, the *second* phase of the recent southern Louisiana initial price ascent, was sparked by the notorious Catco contracts. Those contracts, executed in August, 1956 between Tennessee and four southern Louisiana producer suppliers¹² provided for initial prices of 22.4¢ per Mof. At the time of their execution (and of their final certification, on June 24, 1957) these prices were higher than any previously proposed or authorized for any interstate sale by any producer to any pipeline anywhere in the entire southwest. The circumstances preceding and surrounding their certification by the Commission are set forth in detail in the opinions of the reviewing courts.¹³

Briefly, on June 24, 1957, climaxing a bitterly contested proceeding, the FPC, in a widely publicized decision, abandoned its abortive efforts to hold the existing 17 to 18¢ southern Louisiana initial price line (so recently elevated

other producer certificates at 17¢ or 18¢ per Mcf initial prices without opinion.

It also, in *one* instance, imposed an initial price condition on a producer certificate in another (Oklahoma) producing area. This action was judicially affirmed. *Signal Oil & Gas Co. v. F. P. C.*, 238 F. 2d 771 (3rd Cir., 1956) *cert. denied* 353 U. S. 923 (1957). Nevertheless, the Commission thereafter proceeded to "distinguish" this embarrassing precedent right out of existence. By 1958 it had managed to persuade itself, on the basis of patently inapposite legalisms, that, notwithstanding the clear language of the statute and the judicial affirmance of the *Signal* case, it lacked power to impose initial price conditions on producer sales! It was later to be thoroughly disabused of that notion by the Supreme Court's *Catco* opinion (pp. 391-2).

¹² Continental, Atlantic, Tidewater and Cities Service.

¹³ 257 F. 2d at pp. 718-20; 360 U. S. at pp. 380-86.

from the former 9 to 10¢ line) and bowed to the adamant demands of the Catco producers for unconditioned 22.4¢ initial prices.¹⁴

With that decision any realistic expectation of FPC producer price regulation under Section 7 of the Natural Gas Act was necessarily abandoned. Any further effort to halt, slow down, abate or otherwise control the mass upsurge of producer initial prices was virtually foreclosed—for two full years.

7. The Catco aftermath—June 24, 1957 to June 22, 1959.

That initial prices in post-Catco gas sale contracts would rapidly approach, equal and exceed the Catco levels was preordained by the Commission's June, 1957 capitulation to the Catco producers. Southern Natural Gas Company promptly followed Tennessee's lead from 18¢ to 21.25¢ initial prices, obtaining certificates for purchases at the latter rate only a few weeks after the Catco certification.¹⁵ Ten months later that same pipeline-purchaser was authorized by respondent to pay initial prices of 22.8¢ per Mcf.¹⁶ United's pre-Catco initial price ceiling of 13.5¢ per Mcf now became a thing of the past. Upon re-entering the southern Louisiana market 5 months after the execution of the Catco contracts, it negotiated its first 19.5¢ per Mcf contract. Thereafter, in rapid succession, it concluded purchases at initial prices of 21.3¢, 21.5¢, 22.55¢, 22.95¢, 23.8¢ and, most recently, at the reported price of 24.8¢.¹⁷

¹⁴ *Continental Oil Co., et al.*, Doc. Nos. G-11024, *et al.*, 17 F. P. C. 563 (April 22, 1957), 17 F. P. C. 732 (May 20, 1957) and 17 F. P. C. 880 (June 24, 1957).

¹⁵ *Southern Natural Gas Co., et al.*, Doc. Nos. G-11234, *et al.*, 18 F. P. C. 38, July 12, 1957.

¹⁶ *Southern Natural Gas Co., et al.*, Doc. Nos. G-13082, *et al.*, 19 F. P. C. 558, April 4, 1958.

¹⁷ *Seaboard Oil Co., et al.*, Doc. Nos. G-11970, *et al.*, Opinion No. 309, 19 F. P. C. 416, March 31, 1958; *Superior Oil Co., et al.*, Doc. Nos. G-12121, *et al.*, 19 F. P. C. 637, May 9, 1958; *Sunray Mid-Continent Oil Co., et al.*, Doc. Nos. G-12211, *et al.*, 19 F. P. C. 618 May 9, 1958; *United Gas Pipe Line Co., et al.*, Doc. Nos. G-12712, *et al.*, 19 F. P. C. 931, June 12, 1958; *The California Co., et al.*, Doc. Nos. G-16108, *et al.*, and *Sun Oil Co., et al.*, Doc. Nos. G-15122, *et al.*, *infra*, fn. 23. *The Oil and Gas Journal, Price of Gulf Coast Gas Hits New High*, Feb. 1, 1960, p. 2.

Texas Gas, still able to conclude many purchases at 18¢ initial prices in 1956, notwithstanding its unique, *American Louisiana*-patterned, 1955 21¢ acquisitions, found its ability to buy gas at that level severely curtailed after 1957. Texas Eastern, which had not theretofore purchased gas in the southern Louisiana producing area, jumped into that market after Catco certification with a resounding initial price splash of 23.9¢ per Mcf.¹⁸ Trunkline, formerly a 17.5¢ initial price purchaser, brought this, post-Catco upsurgent phase of initial price certification to its culmination on May 22, 1959 with 24.05¢ initial prices.¹⁹

Several innovations in gas purchase arrangements were devised during this period in desperate efforts by some gas buyers to avoid or minimize, so far as possible, the drastic impact of skyrocketing initial prices. Among them was the arrangement proposed in this proceeding—direct purchase by a distribution company from gas producers, with transportation service only to be furnished by pipelines. Although the cost of such an arrangement might be (and in this case was) considerably higher than the current cost of purchasing an equal volume of gas from traditional pipeline suppliers, the distribution company would at least for a time be safeguarded against future pipeline rate increases occasioned by the latter's future gas purchases at perpetually and steeply ascending initial price levels. That future pipeline gas purchases would be at perpetually and steeply ascending initial price levels was regarded (understandably) as an absolute certainty. For, although final certification of the Catco contracts, concededly induced by the most extreme producer pressures, had literally been extorted from the Commission after two unsuccessful efforts on its part to withstand those pressures, the FPC thereafter became the most enthusiastic and outspoken proponent of its Catco principles and of their sky-is-the-limit results. As a result, the 22.4¢ figure which had become the southern Louisiana initial price *ceiling* on June 24, 1957,

¹⁸ These contracts were subsequently rescinded by the parties prior to Commission action thereupon.

¹⁹ See CADC No. 15365.

rapidly became the southern Louisiana initial price *floor*, with 24.05¢ supplanting it in the upper ranges.

Among the many post-Catco and higher-than-Catco certifications were 39 certificates issued on September 4, 1958 to suppliers of Transco at initial prices ranging from 22.4¢ to 23.3¢ per Mcf (the *Transco-Seaboard* sales).²⁰

8. The Supreme Court's Catco Opinion—June 22, 1959.

During virtually the entire two-year period (June 24, 1957 to June 22, 1959) described above (Par. 7), the Catco certificates were under judicial review, instituted on October 7, 1957 by this petitioner and jointly by two distribution-company customers of Tennessee, the pipeline-purchaser there involved. From and after December 22, 1958 the Transco-Seaboard certificates were also under judicial review, instituted by this petitioner and jointly by two distribution-company customers of Transco, the pipeline-purchaser in that proceeding.

The Catco certificates were in fact judicially overturned by the Third Circuit on June 30, 1958, but upon limited grounds which did little or nothing to discourage the producers and the Commission from proliferating the Catco example and improving upon the Catco prices. Therein, the Third Circuit declined to "reach" the basic question of the illegality and incompatibility of the Commission's certification practices with the public convenience and necessity standard of Section 7 of the Natural Gas Act. It held the Catco certificates invalid because of the unique facts—i. e., voluble producer threats to withdraw the gas from the interstate market and Commission capitulation to such threats—there involved.²¹

No succeeding case duplicated those facts for the very simple reason that the Commission thereafter regularly issued unconditional producer certificates instantaneously, thereby

²⁰ *Transcontinental Gas Pipe Line Corp., et al.*, Doc. Nos. G-13143, *et al.*, Opinion No. 315, 20 F. P. C. 264.

²¹ *Public Service Commission of New York v. Federal Power Commission*, 257 F. 2d 717.

(a) eliminating the necessity or occasion for producers to utter such threats and (b) removing the connotation of FPC subjugation and submission to such threats.

On June 22, 1959, however, the Supreme Court spoke on the Catco certifications.²² It affirmed the *decision* of the Court of Appeals, reversing the Commission's unconditional certification of the Catco 22.4¢ sales, but disapproved that Court's line of reasoning and addressed itself instead forthrightly and unequivocally to the subject of the Commission's regulatory duties and obligations under Section 7 of the Natural Gas Act. The Court noted with emphasis FPC's complete neglect of those responsibilities in Catco and, *perforce, in every subsequent Catco-based and Catco-engendered certificate proceeding*. It was the latter (of which the Court was well aware) which prompted the *critical* observation that prices in southern Louisiana "have now vaulted from 17 cents to over 23 cents per MCF". 360 U. S. 378, 390. The Court delivered a six-page critique (*ibid.* 388-393) of respondent's producer certificate practices and policies, in Catco and in general; deplored the effect of those policies upon the consuming public; and enumerated, for respondent's guidance both on remand and in the future, some of the more obvious considerations which must be brought to the proper application of Section 7 respecting producer initial prices. At the outset of this portion of its opinion it reminded respondent that "The purpose of the Natural Gas Act was to underwrite just and reasonable rates to consumers of natural gas" (p. 388).

9. The Third Circuit *Transco-Seaboard* decision— August 4, 1959.

Little more than a month later, the Court of Appeals issued its decision on the *Transco-Seaboard* certification review. 269 F. 2d 865. With that decision, on August 4, 1959, the Supreme Court's *Catco* opinion, its ink scarcely dry, virtually became a dead letter and remained dormant for four months.

²² 360 U. S. 378.

Although the Court of Appeals intended to follow the higher Court's guidance, it somehow missed the essential point—in fact, the heart and soul—of the entire *Catco* opinion. Thus, it affirmed the Commission's 23¢-plus Transco-Seaboard certifications on the purportedly distinguishing grounds that:

(1) the initial prices there involved were not "out-of-line", as *Catco*'s had been found to be, because they were similar to *Catco* prices and to the prices of *Catco*'s descendants which had been certificated by the Commission since June 24, 1957 [completely overlooking the points (a) that it was the *pre-Catco* "line" that *Catco* was remanded to "hold" and (b) that every *Catco*-engendered certification was, perforce, an invalid point of reference];

(2) there was evidence in the record (lacking in *Catco*) of the pipeline's need for (i.e., ability to market successfully) additional volumes of gas [a point of little consequence in evaluating the propriety of the producer price *per se*]; and

(3) the production of manufactured gas by distribution companies would be even more expensive than the purchase by them of high-priced natural gas [a truism never before considered probative of the propriety of producer-demanded initial prices for natural gas].

10. The Transco-Seaboard aftermath—August 4, 1959 to December 14, 1959.

By the date of the Supreme Court's *Catco* decision, the Commission's unconditional producer certifications had already succeeded in elevating southern Louisiana initial prices to a new high of 24.05¢ per Mcf. However, that decision, for good and obvious reasons, caused the Commission to pause. From June 22 to August 4 no significant additions were made to the high initial price roster.

On the latter date, however, initial prices were deemed, by the producers and the respondent, to have received from

the Court of Appeals another "green light" to soar to any extractable levels, or at the very least, to soar to the highest 24¢-plus level already extracted. Thus, on August 10, 1959, but six days after the Court of Appeals *Transco-Seaboard* affirmance, respondent simultaneously released five decisions in long-pending certificate proceedings affecting this production area. In each it authorized, without condition, initial prices of 23.05¢ to 23.8¢. In each it acted upon records as barren of justification for those prices as had been the Catco record for its initial price of 22.4¢ per Mcf. In each it purported to be acting pursuant to the "teachings" of the Supreme Court's *Catco* opinion, as "embossed" upon (misinterpreted) by the Court of Appeals in *Transco-Seaboard*.

*The instant certification was one of this August 10 group. It and each of its companions was promptly presented for judicial review.*²³

11. The Supreme Court's *Transco-Seaboard* decision—December 14, 1959.

PSC's petition for certiorari to review the Third Circuit's August 4 misapplication of the Supreme Court's June 22 *Catco* determination and disposition, was addressed to each and every ground of the Court of Appeals' decision—including (primarily) the erroneous selection of the price "line" which the high Court had directed must be held, barring convincing evidence of why it should be elevated. Respondent FPC and its producer associates there involved submitted lengthy briefs in support of the Third Circuit's rationale. Therein they had resort to contentions—*identical* with those herein advanced by respondent FPC and its present producer associates—that the Third Circuit on

²³ *Sun Oil Co., et al.*, Doc. Nos. 15122, *et al.*, 22 F. P. C. 351, review pending, *U. G. I. v. F. P. C.*, 5th Cir. No. 18112; *The Superior Oil Company, et al.*, Doc. Nos. G-16380, *et al.*, 22 F. P. C. 369, review pending, *U. G. I. v. F. P. C.*, 5th Cir. No. 18113; *Sunray Mid-Continent Oil Co.*, Doc. No. G-14753, 22 F. P. C. 361, review pending, *U. G. I. v. F. P. C.*, 10th Cir. No. 6280; *The California Co., et al.*, Doc. Nos. G-16108, *et al.*, 22 F. P. C. 252, review pending, *U. G. I. v. F. P. C.*, 9th Cir. No. 16692. PSC is an intervenor in support of petitioner *U. G. I.* in each of the above appeals.

August 4 and the respondent on August 10 had properly applied *Catco's* "teachings." In reply, PSC simply compared the *Catco* certifications with the *Transco-Seaboard* certifications; pointed out the utter inconsistency between the Supreme Court's evaluation and disposition of the former and that of the Third Circuit with respect to the latter; evidenced the import and ramifications of the latter by specific reference to the FPC's August 10 series of certifications; and urged the Court summarily to reverse and order the *Transco-Seaboard* certifications remanded to the respondent for the same reconsideration the Court had ordered to be afforded the *Catco* certifications—i.e., the maintenance of the same initial price "line" the Court had directed respondent to hold (barring proof of the necessity for elevating it) in *Catco*.

On December 14, 1959, the Supreme Court did just that. In so doing, it with unmistakable import corrected the patent error of the Court of Appeals and, incidentally, undermined each and every one of the FPC's August 10 certifications by which that error had been compounded. 361 U. S. 195.

Thus were emphatically removed (1) the Third Circuit's gloss on *Catco*, (2) the Commission's gratefully accepted "green light" derived therefrom and (3) every single prop upon which each of its August 10 unconditional certificate decisions rests.

12. The present status of producer initial prices in southern Louisiana.

Once more did the Supreme Court slow down the course of FPC's headlong, price-is-no-object producer sale certifications. No high price producer certificates for southern Louisiana sales have been issued by the Commission since December 14, 1959.

On the contrary, on January 15, 1960, prompted by *Transco-Seaboard*, the Commission granted PSC's application for rehearing and reconsideration of a November 18, 1959 certificate order authorizing sales at initial prices up

to 23.3¢ per Mcf²⁴—prices *lower* than most of those authorized herein. The order under reconsideration in that case, like the Commission's certificate order in this proceeding, purports to be based on the Supreme Court's *Catco* opinion, as embossed upon by the Court of Appeals' *Transco-Seaboard* opinion. Apparently even the Commission has now begun to doubt that mere citation of and profession of adherence to the Supreme Court's *Catco* opinion is adequate to demonstrate serious consideration of its criticism or serious application of its principles, when the record upon which the Commission has acted conclusively negates any such possibility.

We are asking this Court, the Fifth, Ninth and Tenth Circuits to convert that doubt into certainty, by holding that a Supreme Court decision of June 22, reversing unconditional certification of 22.4¢ initial prices for lack of proof of public convenience and necessity for the price *per se*, does not permit, much less sustain, an August 10 unconditional FPC certification of 23.05¢ and 23.55¢ initial prices, similarly lacking supporting proof of record of the public convenience and necessity therein and therefor.

B.

Producer Rates.

Had the Commission's regulation of producer rates under Sections 4 and 5 of the Natural Gas Act been more effective than its regulation of producer initial prices under Section 7, the consumer cost problem obviously could not have attained its presently chaotic and potentially intolerable proportions. Unfortunately, that has not been the case. The Supreme Court correctly observed on June 22, 1959 that not a single major Section 5 producer rate investigation (including the original *Phillips* rate investigation itself) had yet been concluded by the Commission. That situation remains unchanged today, although almost 6 years have

²⁴ *Transcontinental Gas Pipe Line Corp., et al.*, Doc. Nos. G-16603, et al., 22 FPC

now elapsed since the *Phillips* decision. In the interim the Commission has expended much of its energy in seeking (unsuccessfully) Congressional relief from its *Phillips*-directed responsibilities while groping unenthusiastically with the problems at hand.

The same situation prevails as to major Section 4 proceedings as well, although more than 4 years have elapsed since the Commission was first advised that cost evidence was essential under that section and that application of the traditional, familiar "cost of service" approach to utility rate-making was at least the starting point for its endeavors in this regard.²⁵

Meanwhile, every Commission certification of successively higher initial price levels has either "triggered" or otherwise operated upon contractual "favored nation", price redetermination and price renegotiation clauses, in indeterminable numbers of other gas sale and purchase contracts, thereby multiplying the Commission's rate case work load and inevitably deferring even longer ultimate resolution of these basic rate problems.

The Commission's sole contributions to the reduction of this case load have been (1) approval of producer price settlements reached by the parties²⁶ and (2) termination of its own suspension-refund orders and other Section 4 proceedings respecting producer price increases, which it deemed subject to serious question at the time of their filing, but which are mere "drops in the bucket" in comparison to today's producer initial price standards.²⁷

The upshot of respondent's administration of Sections 4, 5 and 7 of the Natural Gas Act since *Phillips* has been the

²⁵ *City of Detroit v. F. P. C.*, 97 App. D. C. 260, 230 F. 2d 810 (1955), cert. denied 352 U. S. 829 (1956). See also *Bel Oil Corp. v. F. P. C.*, 255 F. 2d 548 (5th Cir. 1958), cert. denied 258 U. S. 804 (1958); *Forest Oil Corp. v. F. P. C.*, 263 F. 2d 622 (5th Cir. 1959) and *Episcopal Theological Seminary v. F. P. C.*, App. D. C. , 269 F. 2d 228 (1959), cert. denied 361 U. S. 895 (1959).

²⁶ *Union Oil Company of California, et al.*, Doc. Nos. G-4331, et al., January 13, 1960, Commissioner Connoles dissenting.

²⁷ *Shamrock Oil & Gas Corp., et al.*, Doc. Nos. G-9146, et al., 22 F. P. C. 205, August 6, 1959, review pending, *Minneapolis Gas Co. v. F. P. C.*, CADC No. 15452; *Cities Service Production Co., et al.*, Doc. Nos. G-9510, et al., January 26, 1960 (unreported); *Petroleum Leaseholds, Inc. (Operator), et al.*, Doc. No. G-18205, 21 F. P. C. 799, May 29, 1959.

following progression of *average* wellhead prices (i.e., the average cost paid to producers for gas supplied under both new and old [pre-1954] contracts) in Louisiana and Texas, the most prolific gas-producing areas in the nation:

	1954	1955	1956	1957	1958 ²⁸
Louisiana	9.7¢	11.2¢	12.4¢	14.2¢	15.5¢
Texas	9.3¢	9.9¢	10.6¢	10.8¢	11.5¢

The impact of this progression on the natural gas consuming public has been, of course, to compel its payment of untold millions of dollars in increased gas rates, attributable solely to producer price increases which (a) have never been justified under the Natural Gas Act, (b) may never be justified under the Natural Gas Act, and (c) to a very large extent, will not even be subject to refund if, as and when they are ultimately adjusted to the statutorily decreed "just and reasonable" level.

ARGUMENT.

I. The record in this case is devoid of evidence, required under the Supreme Court's Catco decision, to support issuance of unconditional certificates.

A.

The initial prices proposed in these proceedings are "out of line" and are unsupported by proof of their public convenience and necessity.

In reversing the Commission's 22.4¢ certifications of the Catco sales, the Supreme Court severely criticized unconditional authorization of initial prices it characterized as "out of line". It specifically commented upon the grave

²⁸ F. P. C. *Direct Sales by Producers of Natural Gas to Interstate Natural Gas Pipeline Companies*—1958, Table 3. Wellhead prices through 1958 do not, of course, reflect the instant initial price (certificated August 10, 1959) nor most post-Catco (June 24, 1957) initial prices. Nor do they reflect more recent increases in existing rates "triggered" by the later high-price certifications. Accordingly, 1959's and 1960's averages will reflect tremendous increases over those of previous years.

results occasioned by the Commission's unconditional authorization of the "out of line" Catco initial prices.

"The prices certificated (in Catco) will in effect become the floor for future contracts in the area. This has been proven by conditions in southern Louisiana where prices have now vaulted from 17 cents to over 23 cents per Mcf. New price plateaus will thus be created as new contracts are made and unless controlled will result in 'exploitation' at the expense of the consumer, who eventually pays for the increases in his monthly bill." 360 U. S. at p. 390.

That the Court was cognizant of the Commission's numerous *post-Catco* unconditional certifications, at equal-to or higher-than-Catco initial prices is, of course, readily apparent from the quoted comment itself. It was also aware that, in isolated instances, the Commission had authorized initial prices as high as 21¢ per Mcf *before* Catco. All of the parties, including PSC, had so advised the Court in their briefs.²⁹

In summarily vacating the Third Circuit's affirmance of the Commission's Transco-Seaboard certifications, the Supreme Court added unmistakable and emphatic, albeit unspoken, underscoring to its *Catco* pronouncements on the subject of "out of line" initial prices. *The principal ground of the vacated decision was that the Transco-Seaboard prices, at 22.4¢ to 23.3¢, were not "out of line," as Catco's had been found to be, because of the great prevalence of similar initial prices in other recently certificated (post-Catco) contracts.*

Again, in issuing its summary order of vacation, the Supreme Court was abundantly aware of each and every high initial price contract, *including the present contracts*, authorized by the respondent Commission. Its attention had been directed to such contracts repeatedly, not only by the Third Circuit's decision, but by the petitions for certiorari and the answers thereto filed by the numerous

²⁹ Brief for Respondent Public Service Commission of the State of New York, Nos. 518 & 536, Oct. Term, 1958, pp. 22-25.

parties involved in that proceeding.³⁰ The Court did not speak in a vacuum, either on June 22 or December 14, 1959. In considering on June 22, 1959 a 22.4¢ jump beyond the 18¢ pre-Catco southern Louisiana price line, and with full knowledge of the *Transco-Seaboard* and other comparable post-June, 1957, Catco-sponsored producer certifications, the Court did not remand *Catco* just to have the Commission point to the Catco progeny and say the "line" has been shoved forward since it first went astray. If confirmation of that were needed, it came on December 14, 1959 when, *in the face of just such an assertion*, 23.3¢ certifications were summarily set aside and remanded to be reconsidered on and with reference to the *Catco* prescribed, pre-Catco "line."

Nevertheless, the Commission here concluded (without the benefit of the ultimate *Transco-Seaboard* disposition—to the contrary, in misplaced reliance upon the now vacated judgment therein) that the 23.05¢ and 23.55¢ initial prices proposed in this proceeding were not "out of line"; concluded that they required no other or better justification for their unconditional certification than that held by the Supreme Court to be inadequate to sustain their lower priced predecessors—i.e., evidence of arm's-length negotiation, of similar prices in the area and of the purchaser's ability to dispose advantageously of additional gas supplies. Moreover, it took the occasion to advise the consuming public—and the gas producers—that (*Catco* notwithstanding) it would *not* require the "conclusive proof" of public convenience and necessity, demanded by the Supreme Court in respect of 22.4¢ initial prices, *for any initial price up to and including 24.05¢ per Mcf!*³¹

Petitioner respectfully submits that Opinion No. 327 is so patently in conflict with the decisions of the Supreme

³⁰ Petition for certiorari of Public Service Commission of the State of New York, p. 15; Brief for the Federal Power Commission in Opposition, pp. 19-21; Brief for Respondent Transcontinental Gas Pipe Line Company in Opposition, p. 29, fn. 44; all in Nos. 459 and 473, October Term, 1959.

³¹ "We shall consider any new application based upon a price in excess of any price we have heretofore certificated (i.e., 24.05¢) to be 'out of line' and shall require conclusive proof from the applicant that the public convenience and necessity requires certification at that price" (R. 4736).

Court that no amount of "interpretation" of the latter can affect their reconciliation.

"As the record shows", says Opinion No. 327, "the prices are the same or lower than numerous other sales certificated in this area" (R. 4735). Petitioner urges that the *Transco-Seaboard* decision, if nothing else, at least has discredited thoroughly the "bootstraps" practice of citing the numerous Catco progeny to confer respectability on still another Catco descendant. Catco—the common ancestor of the "numerous other (high price) sales certificated in this area"—has been overturned. *Transco-Seaboard*—one of its most persistently cited offspring—has been overturned. Virtually all of their high initial price confreres and successors are presently under judicial review with, it is certainly to be hoped, the same disposition impending. Post-Catco, Catco-engendered, and higher-than-Catco initial prices simply do not and cannot furnish a legitimate basis of comparison upon which to evaluate the propriety of similar proposed initial prices. Their negotiation and existence, explicitly and avowedly, was attributable to the original Catco error and those that followed and compounded it. Decisions of the Supreme Court may not be nullified by the Commission's persistent, adamant devotion to its own erroneous determinations.

To demonstrate further that the present initial prices are not "out of line", Opinion No. 327 observes that

"If there has been an increase for natural gas producers in the cost of doing business of 20% between 1954 and 1959, a price of 20¢ in 1954 is comparable to a price of 24¢ in 1959 * * * we have also taken into consideration the fact that most of the gas here involved is produced either offshore or in the bayous which are almost inaccessible and where drilling operations are much more expensive than on dry land" (R. 4736).

There is not, however, one word of evidence in this record to suggest, much less support the Commission's hypotheses,

1. that 20¢ per Mcf was a justifiable or otherwise appropriate initial price in 1954; or
2. that the producer-applicants in this proceeding have experienced increases of 20%, or of any other amount, in costs of doing business since 1954; or
3. that the costs of producing the gas involved in this proceeding bear any relationship whatever to the proposed initial prices.

The Commission concedes that "the majority of sales in that area were made at or below 18¢" prior to Catco (R. 4735). It does not (and cannot) claim that 20¢ represented a just and reasonable price in 1954, or a typical initial price, or an average price, or a median price, or anything other than the very highest price produced by "arm's-length negotiation" between major gas producers and a desperate pipeline purchaser in a sellers' market. In trending *that* figure upward by reference to generalized economic data—dehors the record—and by "consideration" of the costs—unknown—of aqueous drilling operations, the Commission resolutely ignored

1. the testimony of the applicants that their prices were based, *not* on "inflationary" or any other cost considerations, but rather on arm's-length negotiation and on other prices in the area and *nothing* else; and
2. the fact that all of the gas involved in this proceeding was discovered in 1958 or earlier years, that the related costs (whatever they might have been) were incurred primarily in the years preceding discovery and thus were unaffected by inflationary trends of subsequent periods.

Moreover, in resorting to speculation, surmise and unfounded assumptions of this nature, the Commission has flagrantly violated the fundamental and salutary principle that administrative agency decisions must be based on evidence of record, not unsupported, "iffy" surmises.

B.

The Commission's conclusion that unconditional certification would not adversely affect Hope's gas costs and rates, is not supported by substantial evidence.

Hope's witness testified that the estimated weighted average cost of its pipeline purchased gas for the year 1960 would be approximately 37.5¢ and that of its Appalachian area gas approximately 24.05¢ per Mcf (R. 1558-61). The present weighted average cost of the instant supply is approximately 44.825¢ per Mcf.³² That the purchase of this supply, at the proposed prices, *must* increase Hope's cost of purchased gas is, of course, obvious. Hope's witness did not deny that fact. When questioned, he merely stated that he had not made the specific computation called for (R. 1549-51). Nevertheless, Opinion No. 327 makes the categorical finding "nor will there be any increase in the weighted average cost of Hope's gas" (R. 4736)! It also finds that the purchase "will not result in any *immediate* increase in Hope's prices to its customers" (Emphasis supplied; R. 4733).

In this the opinion displays a naivete toward the economic facts of life that is little short of incredible at this late date. As—of all people—respondent should well know, increased gas costs *always* lead to increased gas rates. Tennessee's similar assurances, that its Catco purchases would not necessitate a rate increase filing, very promptly proved to be unfounded.³³ Transco's assurances, that its Transco-Seaboard purchases would necessitate a rate increase of only 2¢ per Mcf, very promptly proved to be unduly optimistic by at least 50%.³⁴ And what, pray tell, does the Commission assume gave rise to its oft-bemoaned rate increase case workload, other than increases in the cost of purchased gas?

Since new high price gas purchases *necessarily* increase purchased gas costs of the buyer and since increased pur-

³² See p. 5 and fn. 6, p. 7, *supra*.

³³ See 360 U. S. at p. 393.

³⁴ See 269 F. 2d at p. 869 and fn. 13.

chased gas costs of the buyer are *invariably* passed on to the buyer's customers, testimony that the present purchases would not prompt an *immediate* rate filing by Hope affords very impermanent comfort to ultimate consumers served through its facilities. On the basis of prior, all-too-vivid experience and plain common sense, it cannot be deemed adequate to support respondent's conclusion that the producer prices would not "adversely affect" that segment of the consuming public.

Conclusion.

The determination and order on review should be reversed; the producer certificates vacated; and the case remanded to FPC for reconsideration and redetermination in the light of *Atlantic Rfg. Co. v. Pub. Serv. Comm'n.*, 360 U. S. 378. Cf. *Pub. Serv. Comm'n. v. F. P. C.*, 361 U. S. 195.

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April 15, 1960.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

OPINION NO. 338

No 15461

Phillips Petroleum Company
Phillips Petroleum Company

)
)

Docket No. G-1148
Docket Nos. G-3175, G-4333,
G-6621, G-7773,
G-8623, G-8695,
G-8883, G-10359,
G-10793, G-10883,
G-11125, and
G-11217

OPINION AND ORDER
DETERMINING COST OF SERVICE
AND TERMINATION PROCEEDINGS

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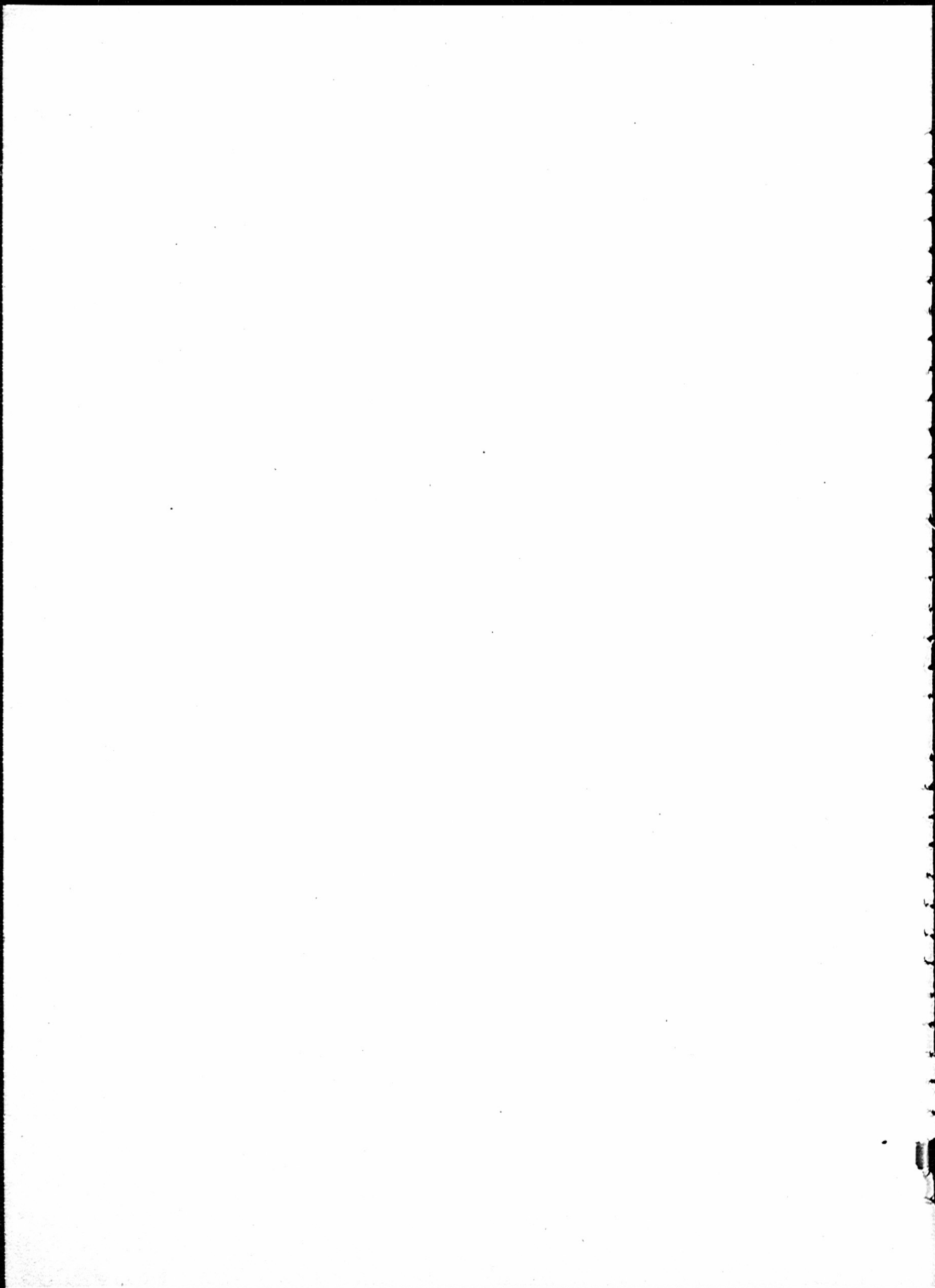
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Joseph W. Stewart

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Issued: September 28, 1960



UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Phillips Petroleum Company)
Phillips Petroleum Company)

Docket No. G-1148
Docket Nos. G-3175, G-4333,
G-6621, G-7773,
G-8623, G-8695,
G-8883, G-10359,
G-10793, G-10883,
G-11125, and
G-11217

OPINION NO. 338

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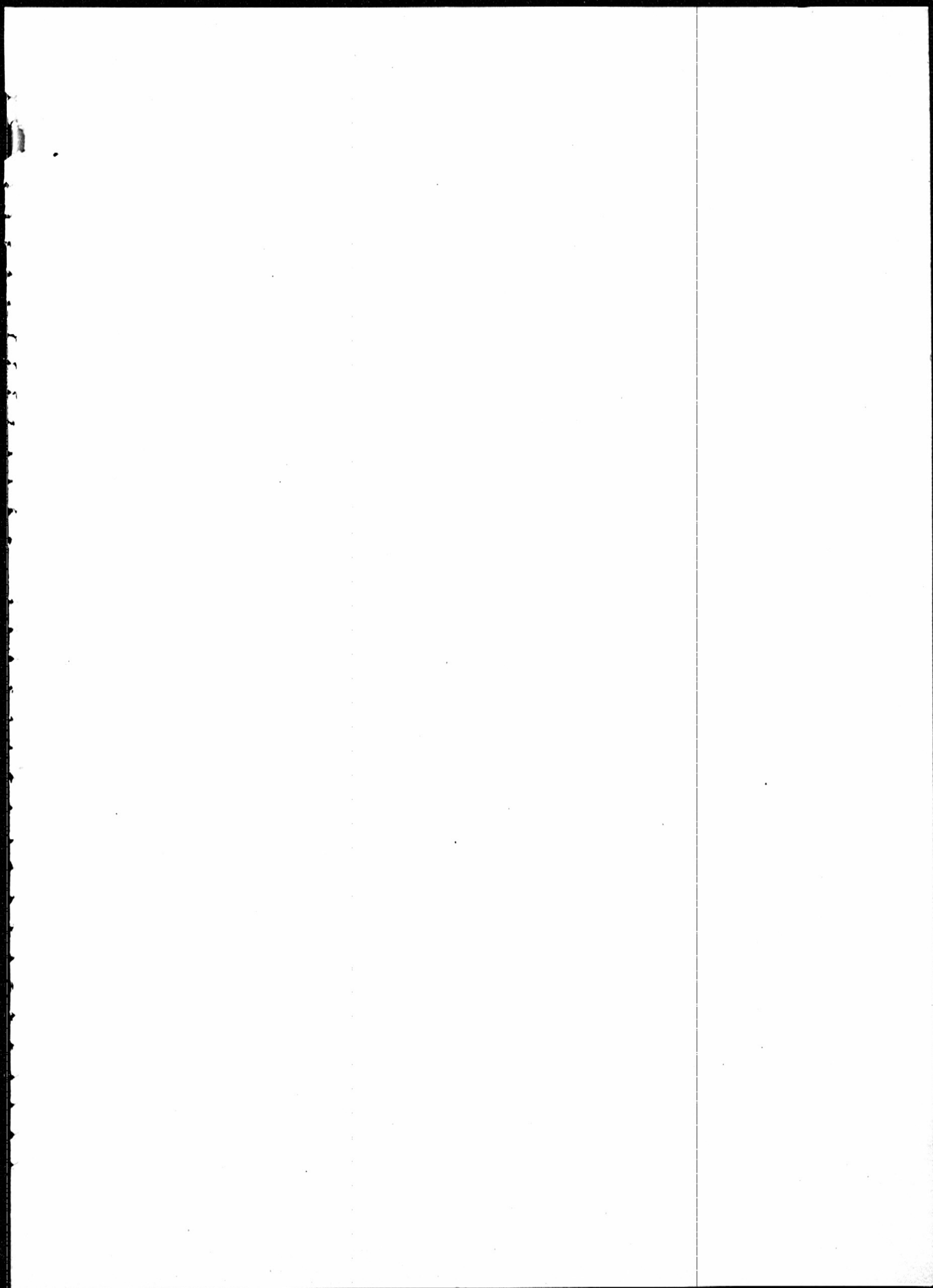
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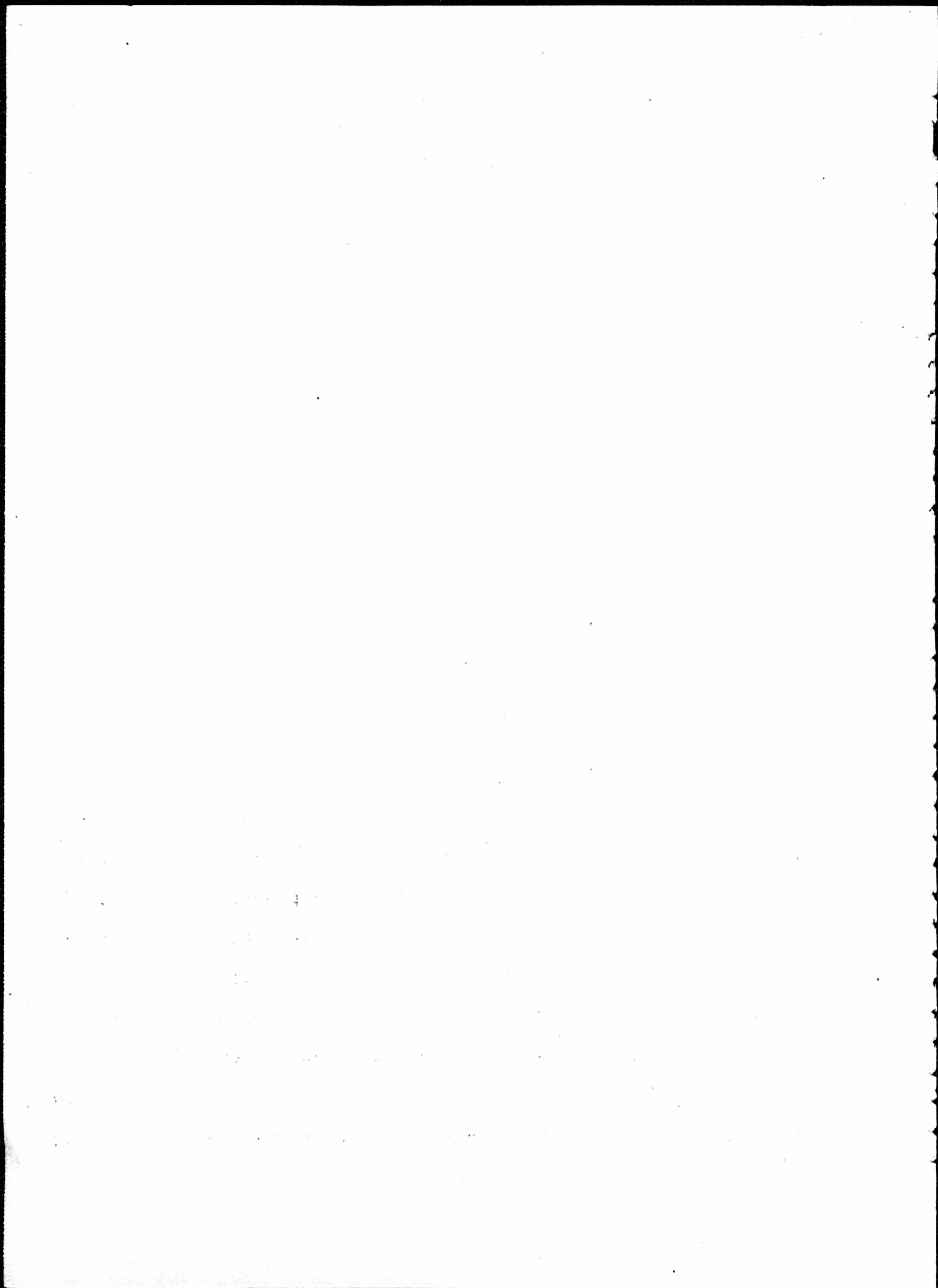
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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Frederick Stueck
and Arthur Kline

Phillips Petroleum Company)
Phillips Petroleum Company)

Docket No. G-1148
Docket Nos. G-3175, G-4333,
G-6621, G-7773,
G-8623, G-8695,
G-8883, G-10359,
G-10793, G-10883,
G-11125, and
G-11217

OPINION NO. 338

OPINION AND ORDER
DETERMINING COST OF SERVICE
AND TERMINATION PROCEEDINGS

(Issued September 28, 1960)

This is a rate proceeding under Sections 4 and 5 of the Natural Gas Act and is a sequel to the decision of the United States Supreme Court on June 7, 1954 in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 which reversed the determination made by this Commission and held that we had jurisdiction over the wholesale rates in interstate commerce of the Phillips Petroleum Company even though it is an independent producer of gas and not a pipeline company. In this proceeding rates have been determined for Phillips by the presiding examiner in his decision issued April 6, 1959, and the issues involved are now before us after the filing of exceptions to his decision and oral argument before the Commission.

The original proceeding arose on October 28, 1948, 7 FPC 983, when we instituted an investigation under Section 5(a) of the Natural Gas Act to determine whether Phillips was a natural-gas company within the jurisdiction of the Commission and whether its rates were unjust or unreasonable. After a hearing, the Commission determined on August 16, 1951, (10 FPC 246) that Phillips was not a natural-gas company, but this decision was reversed by the Court of Appeals for the District of Columbia, 1/ which, in turn, was affirmed by the Supreme Court of the United States in the above mentioned decision.

1/ State of Wisconsin v. F.P.C., 205 F. 2d 706 (CA DC 1953).

As a result of the Court decisions, we vacated on November 22, 1954, our previous termination of the proceedings in G-1148 and reinstituted our Section 5(a) investigation of Phillips' rates. By later orders we consolidated the proceedings in Docket No. G-1148 with proceedings under Section 4(e) of the Gas Act arising out of the suspension of increased rates filed by Phillips in the other dockets listed in the title above. The increased rates proposed in these dockets became effective at various dates subject to refund.

The hearings in the consolidated proceedings commenced on June 26, 1956 and, after 82 hearing days, were closed on December 18, 1957. The parties include Phillips, the staff of the Commission and some thirty-one interveners. At the October 15, 1957 session of the hearing after the presentation of the cases of Phillips and the staff, cross-examination thereon and the supplying by Phillips of additional data at the request of various interveners, counsel for the Wisconsin Public Service Commission moved that the examiner direct the staff to make further studies and present additional data in the record to fill alleged gaps. The examiner and subsequently the Commission denied Wisconsin's request.

On December 2, 1957, two weeks before the close of the hearing, staff counsel moved the examiner to grant a recess of six months to permit the staff to make a further investigation for the purpose of adding to the record data with respect to the cost of Phillips' joint product wells, broken down on an area basis, so as to assist the Commission in fixing rates on an area basis rather than a company-wide basis if it should desire to do so. The examiner denied this motion on the ground that the problems raised had been obvious for some time, that the additional evidence would not necessarily be sufficient, and that granting the motion would result in great delay in the completion of the proceedings. The Commission affirmed the examiner's ruling on this matter also.

Briefs were filed by Phillips, a number of interveners and the staff; and the examiner issued a decision on April 6, 1959 in which he thoroughly analyzed the questions at issue. Thereafter exceptions were filed by Phillips, Minneapolis Gas Company, San Diego Gas & Electric Company, Panhandle Eastern Pipe Line Company, Northern Natural Gas Company and Permian Basin Pipeline Company, Pacific Gas and Electric Company (P.G. & E.), Southern California Gas Company and Southern Counties Gas Company of California (Southern California Companies), Minneapolis Gas Company, Michigan-Wisconsin Pipe Line Company, El Paso Natural Gas Company, the Michigan Public Service Commission, the State of Wisconsin and the Public Service Commission of Wisconsin (Wisconsin), the Public Utilities Commission of the State of California and the staff of this Commission. The Eastern Seaboard Companies ^{2/} filed a statement to the effect that they didn't specifically except to any portion of the examiner's

^{2/} Long Island Lighting Company, Public Service Electric and Gas Company, Philadelphia Electric Company and the United Gas Improvement Company.

decision but asked to participate fully in the oral argument. The Mid-Continent Oil & Gas Association moved to file a brief amicus curiae and a brief in which it objected to the use of the cost of service method of fixing rates for independent gas producers and urged that the present case, in which the evidence was based on cost of service, be decided in such a manner that it not be a precedent in other independent producer rate cases as to the standard for regulation or even as to the cost of service method itself, if that method should be used.

Oral argument was held before us on October 1 and 2, 1959. Representatives of Phillips, the Eastern Seaboard Companies, the California Commission, the Wisconsin Commission, several other intervenors ^{3/} and our staff participated. The issues in this proceeding are thus before us and many questions arise. The most important question is whether the cost of service method should be applied in this proceeding. Assuming that it is necessary for us to use the cost of service method here, very important questions relate to the allocation of costs, particularly exploration costs between oil and gas, the effect of rate increases on the cost of purchased gas, the acreage to be included in the rate base, rate of return and the effect to be given to our cost of service determination on Phillips' rates.

^{3/} City of Detroit, Michigan-Wisconsin, P.G. & E., the Southern California Companies, Minneapolis Gas Company and San Diego Gas & Electric Company.

THE PHILLIPS PETROLEUM COMPANY

Phillips sells more natural gas in the United States than any other oil and gas producer; and it is the largest producer of liquids condensed from natural gas. It also engages in various phases of the oil and petro-chemical business with operations spread throughout the United States and in several foreign countries. Its operations include the exploration for and the production of oil and gas, the purchase of oil and gas from other producers, the gathering of natural gas, the processing of natural gas in gasoline plants for the extraction of liquid hydrocarbons, the refining of crude oil and other petroleum products, the manufacture and sale of various chemicals, the operation of oil pipelines, the sale of petroleum products, and research and development.

While Phillips is the largest seller of natural gas, its annual revenues from this source were but 6 percent of its total gross income in 1955. In the test year 1954, it sold 688,811,312 Mcf, of which 491,178,953 or 71.3 percent were sales for resale in interstate commerce. As the examiner notes, Phillips' natural gas operations extend from the Gulf Coast to Montana and Wyoming with the greatest concentration of sales occurring in Texas, Louisiana and Oklahoma.

Three of Phillips' departments are directly concerned with natural gas. These are the Natural Gas Department, which operates all wells producing dry gas only and all gas gathering systems, the Natural Gasoline Department, which operates the gasoline plants, and the Oil and Gas Production Department, which operates wells producing both oil and gas, including gas condensate wells. In addition, several service departments perform services in connection with natural gas operations. As a result of the operations of these departments, Phillips sells dry natural gas, gas-condensate well gas, raw casinghead gas in the field and from gathering systems, and residue gas at the outlet of its gasoline plants after the saleable liquids have been extracted. In the year 1954, a total of 375,690,912 Mcf was produced, 226,681,178 Mcf in the Natural Gas Department and 149,009,734 Mcf in the Production Department, and an additional 407,984,210 Mcf were purchased. ^{4/}

^{4/} These volumes relate to the United States only. The difference between the amounts produced and purchased and the amounts sold consists of company uses, losses and return to leases, etc.

REGULATION OF NATURAL GAS PRODUCERS' PRICES

With the full proceedings before us involving the largest independent producer of natural gas from the standpoint of sales in interstate commerce the time has arrived when the Commission can express its views on the policies which must be followed in order to regulate the rates of independent producers of natural gas in a sane, sensible and effective manner. Heretofore, we have been confined to the record of particular cases, which generally did not afford a basis for employing the experience which we have acquired in the many cases which have come before us, including, now, this one.

Experience of the Commission in this case, as well as in many other producer rate cases during the last five years, has shown, beyond any doubt, that the traditional original cost, prudent investment rate base method of regulating utilities is not a sensible, or even a workable method of fixing the rates of independent producers of natural gas. The fact that, in this case, we can, by making numerous arbitrary allocations and estimates, arrive at a calculated unit cost of gas does not prove to anyone's satisfaction, including ours, that we have thus solved the problem of fixing prices for natural gas sold by independent producers. We recognize that the use of this method for regulating utilities provides only some possible aid toward solving, but not the answer to, the problem of fixing producers' rates.

Producers of natural gas cannot, by any stretch of the imagination, be properly classified as traditional public utilities. Justice Harlan, dissenting in the recent case of Sunray Oil Co. v. F.P.C., 364 U.S. 137 at p. 160, characterized the difference as follows:

" . . . A pipeline performs a service akin to those traditionally performed by public utilities. The independent producer, on the other hand, is unique among the objects of public-utility regulation because it is not engaged in rendering a service to the public in the conventional sense of that concept, but rather simply in selling a commodity which it owns. . . ."

A natural gas pipeline, under our regulation, usually has a fair opportunity to earn a fair rate of return, but such is not necessarily the case with a producer. The pipeline investor is reasonably assured of the financial feasibility of a project before any funds are expended for construction. The pipeline constructs facilities only after the issuance of a certificate of public convenience and necessity and reasonable assurance of fair rates. The producer must invest his funds prior to ascertaining whether he will have anything to sell or whether, if he does, he will have an adequate market. Thus it is clear that in regulating producers, we are faced with problems entirely different from those presented by an ordinary public utility. Furthermore, to fix rates of gas producers simply by allowing a return on investment or rate base will penalize the efficient or fortunate producer and will unduly reward the inefficient or unfortunate producer. As Justice Jackson put it in his dissent in F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 at 649:

" . . . The service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it, and there is little more relation between the investment and the result than in a game of poker."

Virtually the only situation in which the investment would have a real relationship to the return is where the producer has purchased fully developed acreage at a current fair price. Otherwise the determination of the cost of a producers' assets upon the happening of a certain event, or at a certain point in time will produce unrealistic and inequitable results. Under the cost rate base method the producer who first takes the risk in an area and proves it productive will get the least return, for he will undoubtedly pay less for his rights than those who come in later after the area is proved.

While the examiner felt that the traditional rate base method of rate regulation could ultimately be successfully used to regulate producers' rates, we are convinced that such a method is unworkable, and will produce fallacious results. This conclusion is based not only upon our examination of the record in this case but to an even greater extent upon the knowledge and expertise we have gained from the many producer cases which we have had before us, either after an examiner's decision or upon some matter of procedure or evidence in pending cases, and from years of study of these problems.

We are not dealing with a service requiring certain equipment at known costs. We are dealing in many instances with one of two commodities produced with the same equipment and processed to varying degrees prior to sale. The price of the second commodity, oil, is unregulated, as is that part of the gas, which is sold in intrastate commerce or other transactions not subject to our jurisdiction, as well as the products which are extracted prior to shipment. Thus we are faced with the extremely difficult problem of allocating costs between the regulated and unregulated products. The record shows that none of the experienced, diligent, and intelligent experts who have labored on this problem have proposed any allocations which were acceptable to other experts. Every method of allocation advanced was shown to have at least some element of guesswork or to ignore some facts.

While we must make allocations in all rate cases, the amounts involved in electric and gas pipeline cases have been comparatively small, and the allocations relatively simple. In the case of the producer, the amounts involved in the allocations of costs are major in size and extremely difficult to make. The result is that a producer actually could become bankrupt, or could make enormous profits, depending merely on the methods of allocation used. We do not say that allocations cannot be made. We say that in this kind of case the rates should not be wholly dependent upon them.

Further experience may enable us to refine and improve our allocation methods, but it is clear that the calculation of the unit cost of gas is, and will be an inexact, complex, unsatisfactory, and time consuming process, fraught with controversy. The result finally reached may give the illusion

of accuracy since mathematical processes are involved, and a definite price per Mcf is the final result. But such a result must be tested against the realities of the market place. Thus, prices calculated solely on the cost rate base principle cannot be accepted if they are higher than a buyer will pay, or lower than a seller will accept.

When an unrealistic result is reached, the formulae for allocations must be changed, in order to bring about a reasonable result. The allocation methods then become a means of supporting a result already arrived at, rather than a means of arriving at a result which was previously unknown.

Another difficulty in determining cost of gas per unit is presented by the necessity of using estimates of reserves of gas, which can never be precise and have been shown to be highly inaccurate in many cases, with qualified experts differing as much as 100 percent over reserves in the same formations. See e.g., El Paso Natural Gas Company, Docket No. G-12580, 22 FPC 900, page 904 and 918, et seq.

The rate base cost of service method entails consideration of the tax laws applicable to percentage depletion and intangible well-drilling costs. (I.D.C.) Thus these difficult and disputatious matters, the effects of which are extremely difficult to predict, become major issues, along with the methods of allocation. Instead of simplifying, they obfuscate and hinder the solution to the problem of arriving at a just and reasonable rate for natural gas sold by a producer.

Ridiculous results will be reached among the great number of producers and owners of interests if costs should be the only basis for regulation. In unitized fields many single wells have as many as fifty part owners. If cost is to be the sole criterion, each owner would be required to show his costs. Any other course would presumptively be unlawful and confiscatory as to those owners whose costs were not shown. Under the rate base method, Phillips' new rates could not be said to be fair for co-owners. Thus from each well in the United States every Mcf of gas might have a different price tag. Gas from one well might well range in cost from 1 cent to 10 dollars per Mcf. 5/

In this connection it is to be noted that much of the gas which Phillips sells into interstate commerce is purchased from thousands of independent producers whose rates under percentage-type casinghead contracts are dependent upon Phillips' rates. We discuss this problem more completely below under the subject of Expenses. It should be pointed out at this point, however, that the percentage-type of casinghead contracts which share the proceeds of sale, give automatic rate increases for thousands of producers selling to Phillips with no possible determination by us of actual just and reasonable prices to each seller for such casinghead sales.

5/ See Pan American Petroleum Corp., et al., Opinion 310, 19 FPC 463.

We must also consider the interests of the many royalty owners who are paid a percentage of the price received for the products. If cost is to completely control price, landowners would be well advised to lease only to the producing companies who have and can show high costs. Thus low cost producers who must replace diminishing resources would find it increasingly difficult to obtain new leases. In keeping with such a showing of higher costs we must bear in mind the fact that almost half of the markets for gas in this country are not under our jurisdiction. This gives many producers substantial room in which to manipulate their sales in order to sell only in interstate commerce the gas with the highest production costs.

In his concurring opinion in Colorado Interstate Gas Co. v. F.P.C., 324 U.S. 581, Justice Jackson anticipated the chaos of such a situation when he stated at page 610:

"To let rate-base figures, compiled on any of the conventional theories of rate-making, govern a rate for natural gas seems to me little better than to draw figures out of a hat. These cases confirm and strengthen me in the view I stated in the Hope case that the entire rate-base method should be rejected in pricing natural gas, though it might be used to determine transportation costs. These cases vividly demonstrate the delirious results produced by the rate-base method. These orders in some instances result in three different prices for gas from the same well. The regulated company is a part owner, an unregulated company is a part owner, and the land owner has a royalty share of the production from certain wells. The regulated company buys all of the gas for its interstate business. It is allowed to pay as operating expenses an unregulated contract price for its co-owner's share and a different unregulated contract price for the royalty owner's share, but for its own share it is allowed substantially less than either. Any method of rate-making by which an identical product from a single well, going to the same consumers, has three prices depending on who owns it does not make sense to me. . . ."

Another problem inherent in regulation of producers on a cost basis is the administrative burden of having a full cost rate case for each of the thousands of independent producers. And one case per producer would not be sufficient. The uncertainty of the business assures that a great many producers will have substantial cost and revenue fluctuations from year to year and, if cost were our only criteria, the interests of both consumers and producers would require a full cost hearing repeatedly for each producer. Thus adherence to the original cost rate base method of regulation results in the necessity of a full scale, company-wide cost study of a producer in order to determine whether the price contained in any one contract represents revenue to which the company is entitled. If the Commission suspends a two mill escalation in a contract, and then processes that case in the usual manner, the same work must be done as would be done in a Section 5(a) investigation. This is one of the main reasons why this long drawn out case must

necessarily result in the disposition of relatively few of Phillips' many filings. Certainly we cannot judge Phillips' precise revenue requirements for 1960 and the future based on its costs for 1954.

An illustration of the administrative impossibility of separate determinations for all producers' rates is found in the fact that there are 3,372 independent producers with rates on file with this Commission. ^{6/} The producers have on file with us 11,091 rate schedules and 33,231 supplements to these schedules. Currently, 570 of these producers are involved in 3,278 producer rate increase filings now under suspension and awaiting hearings and decisions. The number of completions of independent producer rate cases per man-year during the first 6 years following the Phillips decision indicate that nearly 13 years would be required for our present staff to dispose of the 2,313 cases pending on July 1, 1960. Within this 13-year period an additional estimated 6,500 cases would have been received.

Thus, if our present staff were immediately tripled, and if all new employees would be as competent as those we now have, we would not reach a current status in our independent producer rate work until 2043 A.D.--eighty-two and one half years from now. Of course, we could expect to improve our techniques and thus shorten the time required to process these cases. If we increased our efficiency one thousand percent, we would achieve current status in 1968--eight and two tenths years from now. And regardless of how much our staff is increased every case must still be reviewed by us and our own time and capacity is not unlimited. ^{7/}

As the cost evidence in this case indicates, and as the examiner found in this case even absent sales manipulations, our function in regard to producers may well become one of permitting increases in gas prices if each producer is to be regulated solely on a cost basis. In this connection, it may be noted that at this time 11 producer rate increase cases have had full hearings and have been finally decided by us on a cost basis. In 10 of these

^{6/} To these add 15,435 non-filing co-owners whose rights should also be considered under any rate base theory.

^{7/} The Bills introduced into Congress to eliminate some smaller producers from our jurisdiction would not actually reduce these figures to any substantial extent. Field unitizations, production fluctuations from year to year, fluctuations in the allowables set by the states, processing contracts and various other factors would prevent such a law from reducing our workload to any great extent beyond that which it has already been reduced by our own regulations in regard to filings.

cases the costs showed that the proposed prices were more than justified. 8/ In the other case, H. L. Hunt, 19 FPC 748, difficulties with an affiliated seller's rate prevented us from deciding the rates of the applicant. Three 5(a) proceedings against producers have been fully concluded and in all three the producers' prices were shown to be justified on a cost basis. 9/ Phillips will add one more to this list.

Of 30 producer rate increases submitted with cost data up to this time, 16 have been accepted by our staff when a study of the data showed that the prices were more than justified even though every accounting issue was resolved against the applicant. The remaining 14 increases have either been settled or are awaiting hearings because of incomplete or unacceptable cost data but not because the rates involved appeared to be wholly out of line with the costs. The indications from these and filings now being studied make it quite clear that regulation of producers on a company-by-company rate base method will in all probability result in higher consumer prices than we would otherwise have. 10/ Since the cost rate base method seems almost always to produce the higher rates it appears that consumers, in most instances, will be thoroughly protected if we place more reliance on existing prices and on applicable economic principles.

In fact, rigid adherence to the rate base method will, in many cases, price the producers' gas completely out of the market. This fact is now abundantly clear: Regardless of variations in allocation methods, allowance for incentives, and other disputed factors, computations of the cost of natural gas which have been presented in the many cases before us, show that natural gas has been, in almost all instances, substantially underpriced.

Furthermore, it is clear that contracts for the sale and purchase of natural gas which were in force prior to June 7, 1954, while presumed as a matter of law to be reasonable, Wichita Railroad & Light Co. v. Public Utilities Commission of Kansas, 260 U.S. 48, are, in most cases, actually reasonable, as tested by cost rate-making principles. Thus, these old contracts provide starting points, which with relatively few exceptions are fair, or more than fair to consumers.

8/ Wunderlich Development Co., 15 FPC 690, Davidor & Davidor, 15 FPC 1236, Christie Mitchell, 15 FPC 751, William Negley, 17 FPC 550, Bayview Oil Co., 21 FPC 405, Rebstock & Reeves, ___ FPC ___, Sinclair Oil Co., 22 FPC 53, Harper Oil Co., 17 FPC 803, Hassie Hunt Trust, 21 FPC 37, Monsanto Chemical Co., 22 FPC 1077.

9/ Gelling Oil Co., 20 FPC 772, Ralph E. Fair, 20 FPC 810, C. V. Lyman, 22 FPC 557.

10/ The main exception to the higher cost situation exists in the gas produced from the Panhandle-Hugoton Field in Texas, Oklahoma and Kansas, which was developed near the turn of the century and has relatively more shallow producing horizons holding tremendous reserves.

From the foregoing, it follows that effective regulation of the price of natural gas must be on some more manageable plan than the rate base method. Thus it is clear that the better method would be to establish fair prices for the gas itself and not for each individual producer. While the evidence here is sufficient to allow a determination on a mathematical basis of the revenue Phillips requires, it appears that the ultimate solution to producer regulation will be in the determination of fair prices for gas, based on reasonable financial requirements of the industry and not on the particular rate base and expenses of each natural gas company.

We are, simultaneously with the issuance of this opinion and order, promulgating a policy statement setting forth rate guidance levels for various producing areas of the country. We are thereby establishing two prices for each of these areas; (1) a price applicable to new contracts above which we will not certificate new sales without justification of the price; (2) a price pertaining to existing contracts, above which we shall suspend price escalations.

This schedule of prices is only for guidance and does not constitute any determination of just and reasonable rates and will not foreclose any person from justifying a particular rate in any area. Prices now shown on this schedule will no doubt be revised from time to time, as experience indicates they should be. Other revisions and refinements no doubt will also be made, such as changes in the boundaries of the areas, provisions for variations in physical qualities of the gas, terms of delivery, and other factors.

Our ultimate objective will be to set prices in all producing areas which will be adequate to maintain the gas supplies needed by the consumers of the nation, but at prices that are no higher than are necessary to accomplish that purpose.

We intend to make use of cost data we have obtained in the past and we intend to acquire and consider cost information in the future. We also intend to use all information of an economic nature we have acquired, and to continue to acquire and use such data in the future. Costs incurred in the past are only a part of the body of information pertaining to the economics of the gas producing industry which is necessary for intelligent regulation of that industry.

Costs pertaining to a representative sampling of the industry in any one area must be accepted as part of the basis for fixing rates for all producers in the area. Obviously, as we have shown previously, it is impossible as well as absurd to obtain the cost data for each and every one of the thousands of producers under our jurisdiction.

We fully realize that some persons will contend that the plan of rate regulation we here announce is not lawful and that we are bound by City of Detroit v. F.P.C., 230 F. 2d 810 (CA-6, 1956), certiorari denied 352 U.S. 829, to calculate a rate base and determine a rate of return, at least as a point of departure. If this contention is correct, then, as a practical matter, adequate regulation of producers appears to be impossible under existing law.

Nowhere in the Natural Gas Act is there as much as one word which indicates that this Commission must use a rate base in determining just and reasonable rates. The correct construction of the Natural Gas Act on this question, both as a legal and as a practical matter has been made by the Court of Appeals of the Fifth Circuit in Forest Oil Corporation v. F.P.C., 263 F. 2d 622 (1959), wherein the Court said:

We do not think that either the Commission or the petitioner should be baffled or handicapped in this new field of regulation by any formulas by whatever name they are known. Specifically, if there is an accounting or rate-making formula known to the public utilities industry as a "conventional rate-base method of rate-making" which the Commission in its order of dismissal in this case said must be used at least as a basis of comparison or point of departure, we say the Commission need not require it unless such method is the only way by which the Commission can make its required determination. . . (263 F. 2d 622, 626).

In dealing with competitive industries such agencies as the Interstate Commerce Commission have found it best to work out regulatory principles based on numerous other standards and criteria. Producer regulation will have to be based on similar considerations. As Justice Jackson stated in his concurring opinion in Colorado Interstate, supra, at p. 612:

". . . Far-sighted gas-rate regulation will concern itself with the present and the future, rather than with the past, as the rate-base formula does. It will take account of conditions and trends at the source of the supply being regulated. It will use price as a tool to bring goods to market--to obtain for the public service the needed amount of gas. Once a price is reached that will do that, there is no legal or economic reason to go higher; and any rate above one that will perform this function is unwarranted. If the supply comes from a region where there is such overproduction that owners are ready to sell for less than a fair return on their investment, there is no reason why the public should pay more. On the other hand, if the supply is not too plentiful and the price is not a sufficient incentive to exploit it and fails to bring forth the quantity needed, the price is unwisely low, even if it does square perfectly with somebody's idea of return on a 'rate-base'. The problem, of course, is to know what price level will be adequate to perform this economic function. . ."

And as the same justice concluded in the Hope case, supra, at page 650:

". . . If natural gas rates are intelligently to be regulated we must fit our legal principles to the economy of the industry and not try to fit the industry to our books. . ."

We realize that any decision we make in this and similar cases will be subjected to the lengthy processes of court review. However, in the absence of the appropriate congressional legislation the resultant delay and uncertainty is an unavoidable hazard.

REGULATION OF PHILLIPS' PRICES

While we have found that the rate base method is not an effective means of regulating the producers' prices, evidence in this proceeding was presented almost entirely upon the cost basis and, of course, there were no ceiling prices issued by us at the time of the hearing. There was some field price evidence introduced, but if field prices could be employed in arriving at rates for Phillips, the evidence was incomplete and unrepresentative of Phillips' diverse sales. Therefore we shall proceed on the basis of the evidence adduced in this case to reach conclusions, as reasonable, intelligent and logical as possible even though we know and have herein stated the difficulties inherent in determining a cost of service for Phillips using the rate base method. This is clearly a lawful way to determine rates for Phillips as illustrated by the City of Detroit case,^{11/} and under the present record is the only possible method, and therefore we shall make every effort to reach a result by this means.

As will be seen from the discussion below of Phillips' cost of service, the difficulties of the rate base method as applied to independent producers are well illustrated. In a number of instances, particularly with respect to allocations and rate of return, it is extremely difficult to arrive at a reasonable result by any formula or systematic method. A number of factors must be taken into account and a decision must be made without any possibility of precisely weighing the factors although we have the record before us and a general knowledge of the gas producing industry. In reaching our decision on the various points, we are of the opinion that it is perfectly proper for us to consider the complicated factors involved and reach a result on the basis of our discretion and judgment--in fact, there was no other way to proceed--but we think that many times repeated application of these judgment factors to the thousands of producers would not be practical or expeditious regulation, as we have explained at length above. In the present proceeding we are as a matter of law permitted to reach results by this method.

"The process of rate making is essentially empiric. The stuff of the process is fluid and changing--the resultant of factors that must be valued as well as weighed."^{12/} "Problems may arise. . . which must be solved despite the absence of a relevant general rule. Or the agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective."^{13/} "Judgment upon--conflicting engineering and

^{11/} City of Detroit v. F.P.C., 230 F. 2d 810 (CA DC), certiorari denied, 352 U.S. 829.

^{12/} Board of Trade v. United States, 314 U.S. 534, 546.

^{13/} S.E.C. v. Chenery Corp., 332 U.S. 194, 202-203.

economic issues is precisely that which the Commission exists to determine."^{14/} The Commission may, in fact, form "it's own conclusion without the aid of expert opinions."^{15/} The problem of the allocation of costs, like the problem of the allocation of service "calls for judgment within the Commission's peculiar and expert competence."^{16/} When the decision "is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts", it "is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process" and it is "an allowable judgment" which the Court "cannot disturb."^{17/}

Upon arriving at a cost of service based upon the facts in the record and our judgment applied to these facts, we are then faced with the problem of rates. As will be set forth below, we do not think that it is appropriate to set rates for the future on the basis of this record in this hearing that terminated December 18, 1957, utilizing a test year of 1954 or 1956 and are therefore terminating the proceedings under Section 5(a) in Docket No. G-1148, particularly since rates for the future will be subject to the area price standards we are announcing. Since we are finding that Phillips' cost of service on the basis of the test year 1954 exceeds its jurisdictional revenues, and on the basis of other considerations discussed below we are also terminating proceedings under Section 4(e) consolidated herewith.^{18/}

We can now turn to the discussion of Phillips' cost of service. Before examining the various items in controversy we may say that we agree with the examiner that 1954 is an appropriate test year for the purposes we have in mind. Phillips had submitted a cost of service study for 1956 which indicated that its jurisdictional cost of service for that year was not very different from 1954. The Southern California Companies contended, however, that Phillips' earnings in 1954, and in 1956 were unrepresentatively low and had requested that a cost of study be submitted on the basis of 1955 operations. The testimony shows that Phillips' higher earnings in 1955 were essentially from operations other than the production of oil, gasoline, and gas. Under these conditions, there would have been little utility in requiring that Phillips submit a third cost of service study, so we shall use 1954 as a test year.

^{14/} Chapman v. F.P.C., 345 U.S. 153, 171.

^{15/} Market Street R. Co. v. Comm'n., 324 U.S. 548, 560.

^{16/} Michigan Consolidated Gas Co. v. F.P.C., 203 F. 2d 895 (CA3).

^{17/} S.E.C. v. Chenery Corp., supra 332 U.S. at p. 209.

^{18/} Two of these proceedings, however, will be left pending until the rates of Phillips' customers are finally determined as explained below.

EXPENSES

Expenses, except for allocation and tax questions, have not given rise to many controverted issues in this proceeding. We shall defer consideration of the total tax and the tax benefits arising from the statutory tax incentives relating to percentage depletion and I.D.C. until we discuss rate of return. Other expense issues relate to the size of oil and gas exploration expenses, the alleged increase in purchased gas costs, and treatment of certain interest deductions for tax purposes.

As set forth by the examiner, Phillips' total exploration and development expenses for gas and oil, before adding return, amount to \$47,474,039. (See Appendix 1). There are included expenses relating to undeveloped lease rentals, drilling tools, expired and surrendered leases, dry holes and land and geological activities. Return and taxes as computed herein would amount to \$10,839,194, making a total exploration cost of \$58,313,233. The Southern California Companies and P.G. & E. contend in their exceptions that Phillips has not met its burden of proof merely by reciting the amount of its exploration expenses during the test year and that such amounts should not be accepted uncritically. The Southern California Companies present figures to show that Phillips' gas reserves have been increasing, that the claimed exploration expenses in the test year 1954 were the highest to that date and that there has been for more than a decade a substantial excess of reserves added over gas produced. They do not object to imposing upon current production, some reasonable portion of current exploration expenditures, but believe that an inquiry should be made as to the extent of the exploration expenditures that should properly be borne by current production. Neither of these parties offers any theory or any criteria for determining how much of the exploration expenses should be included in the cost of service for the test year.

In view of the increasing needs for gas and the increasing costs of obtaining it as shown by the record in this case, we are of the opinion that Phillips' overall exploration costs are reasonable. It is true that Phillips is developing gas reserves at a greater rate than it is producing gas, but the record shows, and it is well known to us, that there is an expanding demand for natural gas. Therefore it is reasonable and prudent for Phillips to develop more reserves each year than it produces. We are of the opinion that Phillips has not shown an excessive tendency in this direction, particularly in view of our treatment of the expenses related to the San Juan reserves sold in place after the test year and are therefore disposed to allow expenses undertaken in the discretion of management to obtain for Phillips adequate reserves to continue its business. It will be noted below that exploration expenses allocated to gas, amount to 3.5 cents per Mcf, which appears to be in line with industry practice.

With respect to purchased gas, Phillips argues that if it is allowed increased rates, its cost of gas will rise automatically under percentage-type casinghead gas contracts with its suppliers, so that it should be

allowed an anticipated increase in the cost of purchased gas. In the cost of service submitted by Phillips, this particular item would amount to \$8,183,917; as the examiner computed a lower cost of service and consequently lower rates, the same item, if it had been allowed by the examiner, would amount to \$1,671,733, as computed by Phillips. The examiner was of the opinion that the purchased gas cost adjustment should not be allowed, for no showing had been made that Phillips' suppliers were entitled to an increase. We think, however, that Phillips' exception should be allowed on this point.

The producer of gas selling to Phillips under percentage-type casinghead contracts receives compensation, at least in part, on the basis of a percentage of the proceeds received by Phillips for the gas and extracted liquids sold from its gasoline plants. In other words, the producer's compensation will be measured not by the amount per Mcf of gas, but by a percentage of what Phillips receives, and the rate is fixed by formula rather than so many cents per Mcf. Although Phillips will pay more per Mcf for its purchased gas, if its own revenues from gas sold from its gasoline plants are increased, there is no change in the percentage and there is no rate change on the part of Phillips' suppliers, for which a rate schedule filing must be made. As Phillips points out, conditions other than a change in Phillips' rates could affect the amount that Phillips pays. For instance, variations in the volumes of gas sold to different purchasers may affect the weighted average price per Mcf paid by Phillips, yet it would be unreasonable to consider this a change in rate.

Our regulations recognize the percentage arrangement and do not contemplate that a change in the amount paid the producer, as opposed to the percentage, will require a rate filing. In any case, the producer under such a contract is not privileged to make a rate filing. Under Section 154.91(e), as amended by our Order 190, 21 F.R. 7616, October 4, 1956, where a producer, under a percentage contract, sells gas to the operator of a processing plant, the operator shall make all filings required to cover the sale, including a "list of the producers from whom the natural gas is purchased, showing the percentum of the resale price received by each from such sale of gas." The producer may not file rate schedules or rate changes whether or not filings by the operator have been made. The regulation notes, however, that the producer is "fully subject to applicable provisions of the Natural Gas Act, including sections 5 and 7(b)."

The purpose of this regulation is to avoid multiple rate filings by many producers selling gas to the plant operators, for there would be thousands of contracts involved in the case of a large operator, like Phillips. Such a large number of filings would make the administrative task of regulating the independent producers almost impossible. Our authority to alleviate a similar situation by regulation was upheld in Sun Oil Co. v. F.P.C., 256 F. 2d 233 (CA5), certiorari denied, 358 U.S. 872. In that case Sun owned a part interest in certain gas producing units in Texas, but was not a signatory to the contract by which the gas was sold. Sun made certain

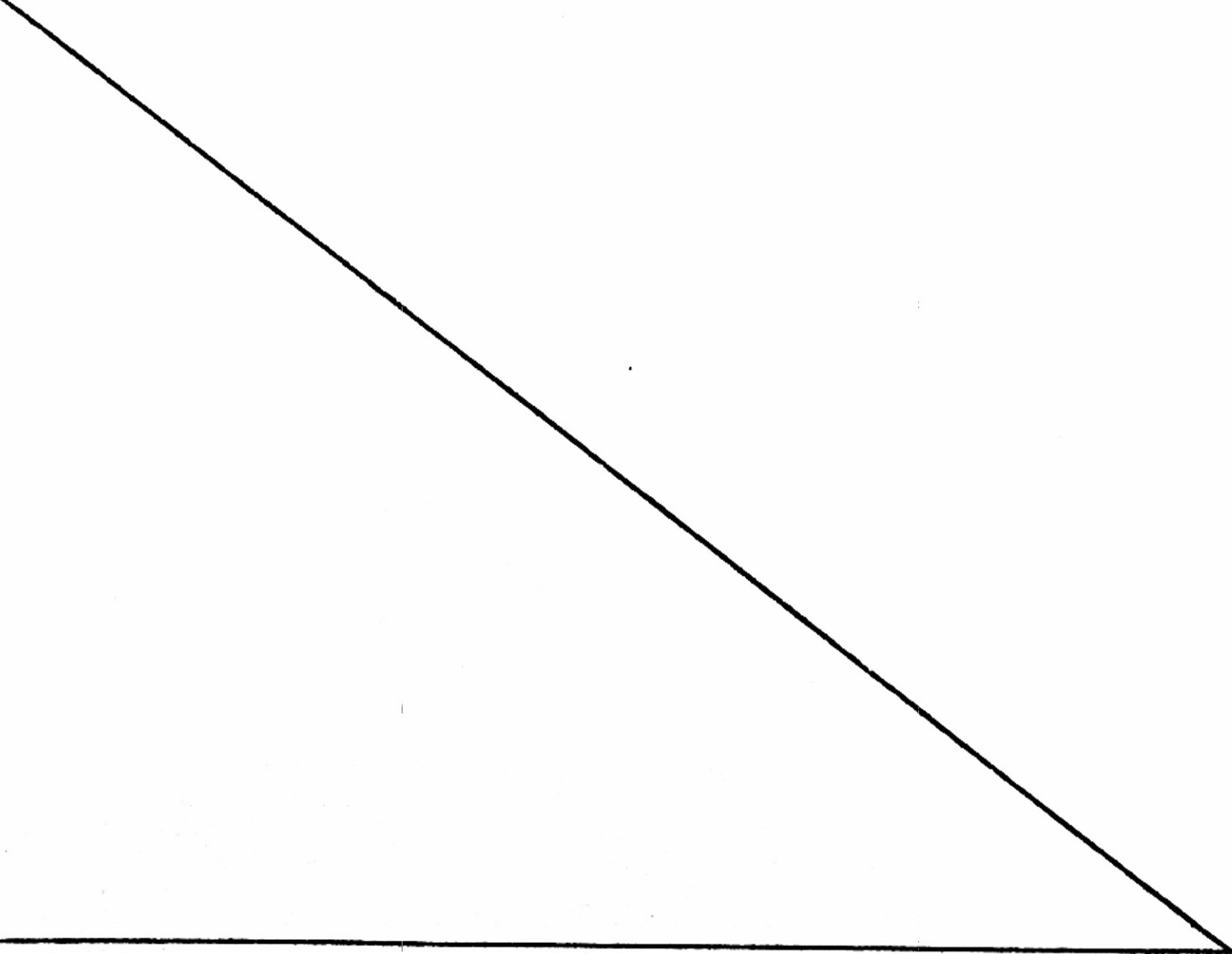
rate schedule filings but the Commission rescinded or rejected these in accordance with Section 154.91 of the regulations. The court noted the burden that would result from an unmanageable mass of rate schedule filings, and held that the rule making power of the Commission was ample to carry out the provisions of the Act, that no injury had been shown, and that the sale by the operator under the operating agreement would be treated as a single jurisdictional sale of the unit or leasehold gas production. The present situation arising under the percentage contracts differs somewhat in that an actual sale appears to be made to the operator entrusted with the task of filing the rate schedules, but our regulation dealing with percentage contracts likewise deals with a situation that would otherwise create an administrative burden. Since the producers selling gas to Phillips under percentage contracts will receive more for their gas as a result of changes we make in Phillips' rates without a rate filing, or other action on their part, Phillips will automatically be required to pay more for its gas, and its purchased gas cost must be adjusted accordingly. It may be noted that we are not allowing any increased purchased gas cost as a result of so-called spiral escalation clauses in the contracts of Phillips' suppliers. An increase under such a contract would constitute a change in rate and would require a rate filing and justification for the increased rate on the part of the supplying producer affected.

It is not possible upon the present record to determine the amount of the purchased gas cost adjustment, for it will depend upon the precise rates in effect for Phillips in the various areas. It is not necessary to make the adjustment for the purposes of this proceeding because we are not determining Phillips' rates for the future and are terminating its Section 4(e) proceedings except for two proceedings left pending for a limited purpose.

Coming to the question of the adjustment for interest deductions for tax purposes, we see that Phillips' actual recorded company-wide interest expenses for 1954 amounted to \$9,892,308, but that in computing its income tax allowance, Phillips used an interest deduction of only \$3,743,077. Phillips argues that this downward adjustment was justified on the ground that the difference of \$6,149,231 represented interest paid in 1954 on an issue of bonds which was converted to common stock by the end of 1955. Phillips says that without this adjustment, the provision for Federal income taxes in 1954 is understated and therefore unrepresentative. We agree with Phillips on this point.

Ordinarily, of course, we use the actual test year as a basis for determining cost of service, but we make adjustments for known changes occurring after the end of the test year. Mississippi River Fuel Corp., 11 FPC 288, 291, 306; El Paso Natural Gas Company, 22 FPC 260, 263, remanded on other grounds as El Paso Natural Gas Co. v. F.P.C., ___ F. 2d ___, (CA5, Aug. 2, 1960), Nos. 18022, 18120, 18124. The examiner attempts to show that actual interest expense and the debt ratio for 1954 were not abnormal compared with the years both before and after. Interest expense in 1953 was \$8,151,028,

\$9,892,308 in 1954, \$8,069,506 in 1955 and \$6,782,565 in 1956, while the debt ratio was 22.4 percent in 1952, 28.6 percent in 1953, 27.7 percent in 1954, 11.6 percent in 1955 and 20.5 percent in 1956. It appears to us from these very figures that interest expense and debt ratio were on the high side in 1954 compared with other years. The issuance of additional debt after 1954 is related to additional assets on which an additional return would be earned, but is not relevant to the test year and must be disregarded. On the other hand, the debt associated with the 1954 assets and rate base was reduced substantially soon after the end of the test year. Thus the downward adjustment of the 1954 interest expense becomes proper in order to normalize the test year. The amount to be deducted would be \$1,895,730 when allocated to the Natural Gas Department and the Oil and Gas Production Department on the basis of dollars of consolidated net assets as shown in Appendix 4.



ALLOCATION OF PRODUCTION COSTS BETWEEN OIL AND GAS

Phillips produces gas alone on certain leases, oil alone on other leases, and both together on still other leases. The purely gas leases are operated by its Natural Gas Department; the oil only and joint products leases are operated by its Oil and Gas Production Department. The determination of the production costs, other than exploration costs, of the dry gas in the Natural Gas Department is, in the case of Phillips, relatively simple; the determination of production costs of gas produced with oil and condensate in the Production Department involves a number of most perplexing problems. For the purpose of allocating joint production costs (exclusive of exploration costs), amounting in all to \$65,252,443 including return and tax incentives as set forth in appendix 5, between oil and gas produced from the same wells, a method known as the relative cost method was employed by witnesses for Phillips, the Eastern Companies, and by Wisconsin and was adopted by the examiner. This method allocates the actual costs of joint oil and gas production in proportion to the known costs of producing each product separately. The staff, on the other hand, used an imputed cost method, supported by a sales realization method, but this was rejected by the examiner.

We agree with the examiner that the imputed cost method does not constitute a satisfactory basis for the determination of the cost of Phillips' casinghead and condensate gas produced in the Oil and Gas Production Department. The imputed cost method does not allocate Phillips' total costs. It merely assumes that the unit cost of the casinghead and condensate gas is the same as the unit cost derived from dry gas produced in the Panhandle-Hugoton Field without using or reflecting the actual total costs of the joint product wells. Furthermore, it appears that the dry gas costs in the shallow Panhandle and Hugoton fields were the lowest gas production costs on the Phillips System.

As the examiner states, the relative cost method is particularly suitable for allocating the joint production costs of a company such as Phillips where the number of leases and the geographical spread of operations provide a broad base for determining the unit costs of the separate products exclusive of exploration. Under the relative cost method a unit cost for dry gas is determined from the records of Phillips' Natural Gas Department; a unit cost for oil is obtained from the records of Phillips' Production Department relating to 100 percent oil leases and as a result of the allocation of indirect expenses between the 100 percent oil leases and the joint product leases. These unit costs for the two products are multiplied by the volumes of oil and gas produced on the joint product leases. This provides a tentative total relative cost for the oil and gas produced from such leases and a ratio of tentative gas cost to tentative total cost. This ratio is then applied to the total actual cost of the joint product leases to obtain the cost of the jointly produced gas. (See Appendix 5)

In applying the relative cost method, Phillips divided production costs into: (1) direct expenses, including depletion, depreciation, and amortization which are shown in the records by leases, (2) indirect expenses, which must be allocated to leases and (3) return and taxes, based on investment identifiable by leases. This classification appears to be appropriate and we have utilized it in the computations set forth in Appendix 5. The indirect expenses amounting in all to \$20,106,343 may properly be divided into direct general expense and indirect overhead.^{19/} The direct general expense item includes expenses as salaries of management, thrift plan expense related to the salaries, employee's retirement and insurance expense, vacation expense and bad debt expense. These expenses relate principally to the Oil and Gas Production Department, but also to the Natural Gas Department, gathering system and gasoline facilities, and the residue gas system (see Appendix 1). The examiner included with direct general expense relating to the Oil and Gas Department, such items as developmental dry hole expense, lease rental expense, expired and surrendered leases and certain developmental land and geological expense to form an item called departmental general expense of the Oil and Gas Department which he allocated between the 100 percent oil leases and the joint product leases in that department. We are of the opinion that all exploration and development items are so closely related that they should be allocated together and apart from the production expenses with which we are concerned here. It is often a difficult matter to separate developmental expenditures from purely exploration expenses. For instance, it is not always possible to tell whether a well is drilled to develop an established field or to discover a new source of gas or oil, and many dry wells are drilled in areas where oil has been proven. All wells are, in a sense, exploratory.

The indirect overhead consists of Phillips' top-level company-wide management expenses, such as salaries and related items. It is actually composed of expenses similar to those found in direct general expense but at a higher level in the corporate hierarchy.

Turning to the method of allocation, we find that Phillips allocated the indirect overhead by first determining the portion of this item to be assigned to the Natural Gas Department and the Oil and Gas Production Department on the basis of net capital employed. There was no dispute about this method and we shall employ it here as set forth in Appendix 1. Phillips then distributed the portion allocated to the Oil and Gas Department between the 100 percent oil leases and the joint product leases on the basis of net investment, and the examiner acquiesced in this method for the indirect overhead. This step was necessary, as indicated above, in order to separate those costs dealing with oil and to obtain a unit cost for oil which could be used to determine the separate oil and gas costs of the joint product leases.

^{19/} The examiner uses the term general company overhead for this item (Mimeo, p. 49).

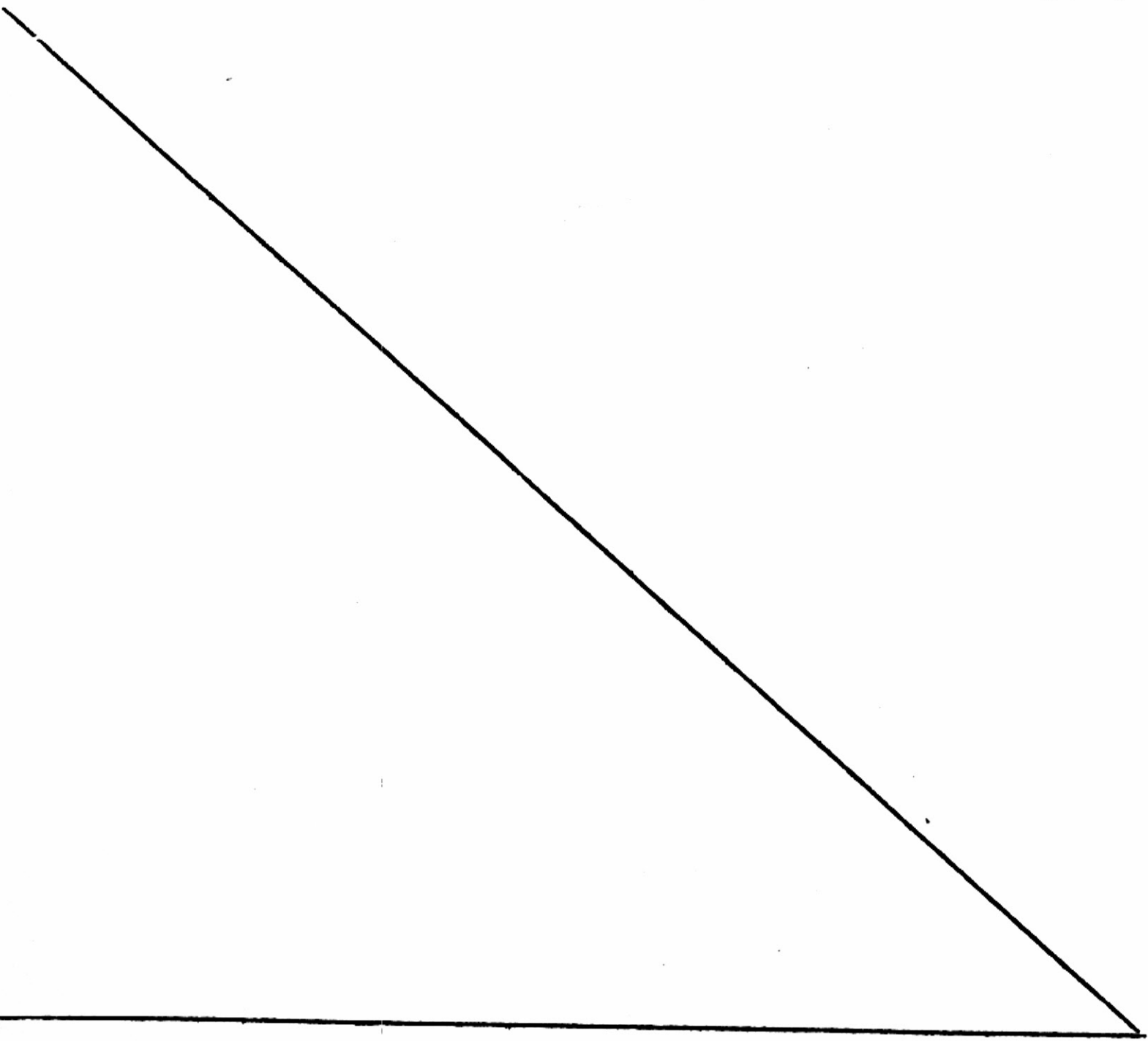
We, however, are of the opinion that the distribution should have been made on the basis of direct operating expenses.^{20/} Management's function is concerned with the direct operation of the business in any particular year. It is concerned with all expenditures, not just with investment. No relationship has been shown between investment in the property and the amount of time spent by management in supervising the various activities of the company.

A similar problem arises with respect to the distribution of the direct general expense of the Oil and Gas Department as discussed at some length by the examiner. This item, as stated above, also consists largely of salaries, and should properly be distributed between the 100 percent oil leases and the joint product leases on the basis of direct operating expenses. In allocating this item along with developmental dry hole expense as "departmental general expense" the examiner employed the gross investment method while Phillips, in its exceptions, said he should have used the net investment method. Since the items relating to lease investment have been transferred to exploration and development expense and allocated as such, the principal basis of employing an investment method, either net or gross, has disappeared, and the allocation of the management items should be carried out on the basis of direct operating expenses.

In applying the relative cost method to allocate the joint production costs the question arises whether a credit should be given to gas for its use in lifting the oil. Testimony in the record showed that gas enables the recovery of a greater amount of oil from a pool than would otherwise be possible. It does this by reducing surface tension, viscosity, and specific gravity and by providing a source of energy which moves the oil through the formation to the well bore and thence to the surface of the ground. Phillips presented evidence that only the gas content up to 300 cubic feet per barrel of oil contributes to the recovery of oil. The record does not finally resolve this question nor does it provide a way of computing the credit for any supposed lifting effect of the gas. In fact, we think that it would be almost impossible to compute the value of the lifting effect of gas in oil production. Furthermore, it can be said that the lifting effect of gas is not so much a reason to give a credit to gas, but reason to increase the value of gas, for lifting oil is a very valuable use for gas.

^{20/} Actually the difference between the two methods is relatively insignificant in result. Phillips allocates the \$7,622,773 of Oil and Gas Department indirect overhead \$1,675,853 to the 100 percent oil leases and \$5,946,920 to the joint product leases while our distribution of the same amount is \$2,385,318 to the 100 percent oil leases and \$5,237,455 to the joint product leases.

As Phillips points out, the 100 percent oil leases, which do not have the benefit of the gas lift, appear to represent a higher unit cost of oil production than the joint product leases, while the dry gas leases represent a lower unit cost of gas production than the joint product leases. Thus when the relative cost method is applied to Phillips, this factor tends to shift costs to oil compensating the gas for the lifting effect, if present. Therefore, we do not see any necessity in this proceeding in crediting gas costs with a possible service to oil production, particularly in view of the inadequacy of the record.



ALLOCATION OF EXPLORATION COSTS

Like independent producers generally Phillips incurs substantial costs for exploration and development for the purpose of maintaining its oil and gas reserves. These exploration and development costs are not directly associated with successful wells whose costs are accounted for as investment and in this proceeding are included in the rate base;^{21/} these costs do include the costs of unsuccessful exploration and, under the practices of the industry, are included in current expenses. There is no dispute as to the necessity for including an allowance for such costs in Phillips' cost of service, but there is considerable dispute as to their allocation between oil and gas.

Total exploration and development expenses before return amount to \$47,474,039 and return and taxes on exploration investment as computed herein amounts to \$10,839,194, making total exploration costs of \$58,313,233 as discussed above and as set forth in Appendices 1 and 7.^{22/} The problem before us is how to divide these exploration costs between the production of gas on one hand and oil on the other.^{23/} While a portion of the exploration costs can be attributed directly to Phillips' Natural Gas Department and were so recorded, the greater part are joint costs for which some technique of allocation is necessary. We feel, as explained below, that it is appropriate and in the public interest that we deal with the allocation of Phillips' test year exploration costs as an allocation of joint costs between co-products with each required to bear its proper share of the joint costs in the light of all of the circumstances that affect the incurrence of the joint costs.

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- ^{21/} Intangible well drilling and development costs are expensed for tax purposes as discussed below.
- ^{22/} As explained above, page ___, the examiner included as departmental general expense of the Oil and Gas Production Department, certain developmental dry hole expense (\$4,521,943), lease rental expense (\$163,716), expired and surrendered leases (\$24,750) and developmental land, geological and geophysical expense (\$1,699,037) but we combine them with the similar costs of the Natural Gas Department in exploration costs and allocate the combined amounts.
- ^{23/} Gas in this section includes vapors subsequently removed as liquids in gasoline plants; the allocation of cost between dry gas and extracted liquids is discussed in the following section.

Ideally we would like to find some characteristic of gas on the one hand and oil on the other that would provide a simple and logical basis for allocating Phillip's exploration costs. No such characteristic has been shown to us, nor have we been able to discover any such characteristic of the respective products or any one method of allocation which will satisfactorily form a basis of allocation. What we are striving to do is to reflect not only the market demand for the two products, and the amount of physical material acquired, but also the trend of economic events by which there now appears to be a market glut for oil, but a continuous and expanding demand for gas. As a guide to final judgment it is extremely useful to examine the various methods of allocation presented in this proceeding and the results reached.

We find that Phillips, itself, employed what may be termed the net leasehold investment--Btu method. By this method Phillips proposed, first to divide exploration costs between its Natural Gas Department and its Oil and Gas Production Department in proportion to net investment in producing leaseholds. Of the amounts so allocated to departments, a portion was first allocated to royalties owned by Phillips, in the amount of \$2,393,368, using the same basis. Then costs were allocated between oil and gas in the Production Department in proportion to test year Btu production of each product.^{24/} The exploration costs allocated to gas in the Natural Gas Department were added to the amount allocated to gas in the Production Department. Under this method, on the basis of Phillip's computation, 61.88 percent of exploration costs were allocated to gas. Phillips argued that the net leasehold investment method would reflect its experience and the fact that exploration is basically a search for reserves, and supports the Btu approach by saying that oil and gas exploration is a search for energy.

The Btu method undoubtedly has some justification and considerable appeal because of its simplicity and convenience. Exploration operations are frequently undertaken without clear knowledge of whether gas or oil, or both, will be found. Thus when either or both of these products are found it is difficult to ascribe the purpose of the exploration wholly to the respective market values of the products, so that there is considerable logic in comparing the products upon the basis of a common physical characteristic. On the other hand, such a method reflects only in part the potentialities of the hydrocarbon products. Oil and gas are not produced, purchased and used merely on the basis of Btu content or available energy. The transportation, refining, distribution and utilization factors are equal to or greater than the factors of exploration and development. As the examiner explains, the chief function of the oil industry is to provide fuel for transportation. Oil and its component, gasoline, are basically useful because they provide energy in compact, mobile and easily controlled liquid form.

^{24/} A Btu (British Thermal Unit) measures the heating value of the product. It is the amount of heat required to raise one pound of water one degree Fahrenheit.

Actually, the heavier the crude oil, the higher will be its Btu content but the lower will be its gasoline content and its price. Gas, on the other hand, does not have the mobility of oil, for it must be carried in pipelines under pressure and used under limited conditions. Both oil and gas are used for the manufacture of chemicals and plastics which could not be properly compared on the basis of Btu. Thus if the Btu method is to be made practicable and useful for the allocation of costs it must be modified by the exercise of judgment based on the facts and the principles that guide producers in the incurrence of costs. Such a modification is carried out below.

The Eastern Companies advocated a method of allocation known as the "Reserves Added Realization Method" (RAR). Under this method, exploration costs were allocated on the basis of the ratio of the reserves of natural gas and natural gas liquids retained by Phillips to the present value of all additions to reserves of all products during the selected base period, whether sold or retained. The method thus makes an automatic adjustment for the large amount of reserves in the San Juan Basin sold to Pacific Northwest Pipeline Corporation in 1955. In applying this method, which was adopted with certain modifications in the computation by the examiner, the Eastern Companies used the base period of 1951-1955 and a price for natural gas of 13.47 cents per Mcf, which represented the weighted average price paid by interstate pipelines for gas delivered in 1956 under new contracts in the Panhandle-Egerton, West Texas, Permian Basin and Gulf Coast areas. For natural gas liquids they used Phillips' 1956 average sales realization of \$1.587 per barrel and for crude oil and condensate the first half of 1957 average mid-continent price quotation of \$3.07 per barrel. On the theory that the deliveries from these reserves would be made over an extended period, they applied an escalation of two cents every five years for the gas and a discount period of 20 years for the gas and 10 years for the oil at a discount rate of 6 percent. The examiner adopted this computation of escalation and discount. The result of this method, as employed by the Eastern Companies and the examiner, is to allocate 30.46 percent of the exploration costs to gas.

RAR has the advantage of basing the allocation on the objective of exploration, that is the reserves acquired, and arrives at a result which, as will be seen, lies between the extremes represented by other methods and does not appear unreasonable, but it has severe disadvantages. Thus RAR results in the unregulated prices of natural gas liquids and oil influencing our determination of the cost of gas and therefore the rate which we would allow for gas. RAR is dependent on market prices; as regulation of the producers proceeds, the use of RAR in future proceedings would be dependent in part on regulated prices that will be used in part to determine regulated prices. RAR is rooted in the theory that there is an association of unsuccessful exploration costs with the result of successful drilling during a given period, but this is inconsistent with the accounting for exploratory losses and costs as current items and could yield unreasonable results over a limited period. Furthermore, RAR has a

very serious administrative disadvantage in that it is very difficult to estimate the size of the gas and oil reserves of a producer. Experience has shown that experts differ substantially as to the size and deliverability of the reserves. Furthermore, the estimates are inherently subject to periodic change as a result of experience with the lease or field involved. Therefore, we are of the opinion that while the results may not be substantially unreasonable in this case, RAR is not a satisfactory or workable method of allocating exploration costs.

The witness for the Eastern Companies among other methods, also computed an allocation of exploration costs to gas on the basis of sales realization. This means that the allocation would be made on the basis of the revenues from the respective products during the test period. The result of this method would be to allocate 20.7 percent of allocation costs to gas and 79.2 percent to oil. When the sale of reserves is considered, 16.9 percent of exploration costs would be assigned to gas, 64.5 percent to oil and 18.6 to the sale of reserves. The sales realization method has the advantage of reflecting the market demand for the products, an important factor to be taken into consideration. It is, of course, subject to the same disadvantages as RAR in its dependence on unregulated prices for oil and natural gas liquids, and, in the case of future proceedings, in its dependence in part on regulated prices.

Several other methods of allocation presented in these proceedings depend in part on the sales realization method. The successful wells method, presented by witness for Southern, divides the cost of the dry holes between oil and gas in the same proportion as Phillips' successful wells. In employing this method, it was necessary to use sales realization to allocate the joint-product wells. The result of this method was to allocate 25.8 percent of exploration costs to gas. We agree with the examiner that the method is founded on a mythical ratio which reflects merely the relative number of dry holes placed in the gas or oil categories and neglects other factors. The method advocated by Consolidated Edison divides exploration costs between Phillip's departments on the basis of depletion expense followed by use of a conventional sales realization method based on gross revenue data to allocate Production Department exploration costs between oil and gas. The Pacific Companies employed a net contribution to earnings method which was based upon net revenues determined, in part, by the sales realization method, and resulted in allocating 23.98 percent of the exploration costs to gas.

The witness for Wisconsin employed a net revenue method. He first determined gross revenues to be used for each of the categories of crude oil, oil from joint-product leases, gas from joint-product leases, dry gas, royalties owned operations, and cycling operations. For his gross revenue figure for gas he employed the ultimate total cost-of-service which he computed for that product. From such gross revenues he deducted total operating costs for each category and made his allocation on the basis of the net revenue figures. In order to carry out this method, it was thus

necessary to use the final result in order to perform an intermediate step, the allocation of exploration costs. The testimony indicated that this would involve complicated computations which were not set forth in the record. This method, which allocated 20.8 percent of exploration costs to gas, appears to us to be circular, unduly complicated and not supported by the record.

As can be seen, there is some merit to each of the allocation methods advanced by the parties, but they all have their defects. At one end of the scale can be found the sales realization methods with their emphasis on market and at the other end the Btu method with its attempt to equate oil and gas from the physical standpoint and to avoid the effect of market swings in price, particularly the price of an unregulated product. In view of the advantages of the various methods we are unable to arrive at a rigid formula for the allocation of exploration costs, nor do we think it would be desirable to do so. The relationship of gas prices and oil prices, the relationship of gas to oil in the corporate economy and other factors will differ from case to case, so that an equitable allocation must vary in order to reflect the place that gas and oil hold in each producer's exploration program.

In making this allocation, we are confronted with the fact that substantial exploration expenditures must be generated through current revenues in order that oil and gas reserves can be discovered in sufficient volumes to maintain service and economic stability of the industry. In other words, the gas consumer must pay rates sufficient, among other things, not only to amortize the cost of the successful past drilling which makes present service possible, but also the current losses and other expenditures incurred in an attempt to replace the gas currently being produced and consumed and continue service in the future. This objective is important socially and militates against a formula for the allocation of exploration costs. However, we are not entirely without the guidance provided by the fuel value of the various products, market factors and economic trends.

None of the parties challenge the fundamental fact that it is the Btu content of fuels that makes them useful to consumers. The argument has been in regard to the importance to be accorded such energy contents of oil and gas in regard to the allocation of their joint exploration costs, and conversely what importance should be accorded the economic factors that producers consider in incurring such costs, and which affect the sale of oil and gas in the fields in different fashions. It is well known in the producing industry that it frequently is impossible to predict whether gas or oil will be found, although certain areas are more favorable for finding gas and other areas more favorable for finding crude oil. To this extent exploration cannot be entirely responsive to market price and it becomes reasonable to allocate the cost of the operation on a physical basis. On the other hand, exploratory activities are directed to obtaining saleable products so that it seems reasonable that market relationships should also be reflected in the allocation. Furthermore, developmental activities are directed towards the production of known reserves and such activities would reflect market conditions. We must also take into

account that there is a continuous and expanding demand for gas while the market for domestic produced crude oil and its components is also growing, but at a slower rate.

Historically, much of the jointly produced casinghead gas was produced as a waste by-product from the production of crude oil, and no avoidable costs were incurred either for its exploration or production. Later, with improvements in conservation, gathering and processing costs became justified to save the gas for field uses and these were considered the only costs chargeable to this gas. Now with a growing appreciation of this gas as a fuel supply for distant consumers, it is considered a co-product of crude oil in exploration as well as production. Much of such gas production now serves first as an aid to recover additional oil and gas liquids and after this, becomes available to distant gas consumers for the same uses as naturally dry gas. The output of this gas has mounted with the output of crude oil. This type of gas has, therefore, now become an integral part both of the producers joint exploration and production activities and contributes substantially to the total gas supply.

Deeper drilling in recent years has also discovered increasing proportions of gas to liquids. The contents of some of the recently developed gas-condensate reservoirs exist wholly in the gas phase; and a portion of the gas condenses naturally during the production process into a liquid that is separated and sold as light crude oil. In such instances, conservation of these liquids has sometimes required that after recovering the liquids from the gas, some or all of the gas be cycled or returned to the reservoir temporarily to maintain the reservoir pressure, and prevent condensation and loss of the liquids in the reservoir. In areas where these types of reservoirs are likely to occur, equal consideration is given to both products in conducting exploration as well as recovery. Phillips has also shown that over a period of years this changing pattern of production and conservation has entailed increases in the joint production investment costs per unit of output.

Because of the industry tendencies that have developed, we deem it appropriate that in allocating the joint exploratory costs and development losses of Phillips, we shall give increased consideration to the Btu's in gas as a fuel as compared with oil and not confine ourselves entirely to a relationship based solely on recent historical relative values or relative production costs. The allocation method adopted, must also encourage the exploration and development of gas as compared with oil. Furthermore, we must take into consideration that the demand for gas is increasing at a more rapid rate than that for oil, and exploration and development activities are planned and costs must be incurred some time ahead of actual production.

In dealing with exploration costs, it is appropriate that the changing outputs of each product should bear the changing exploration costs in proportion to the contribution that such costs make to each supply, and it

is necessary for currently produced gas to bear an increased proportion of the joint exploration costs and development leases if the growing gas demands are to be supplied on a continuing basis. Our purpose, as in past proceedings, is to require that each class or customers bear its proper share of the cost^{25/} Furthermore, in this proceeding we have the particular problem, apart from the traditional methods of allocation based upon past experience, of providing Phillips with sufficient funds for future exploration and production. This is a problem whose solution must depend not only upon costs but on the exercise of judgment. In the Colorado Interstate case, the Supreme Court said "Allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science." (324 U.S. at p. 589).

Expressing all of the factors quantitatively, we find that when we take the Btu content of a standard measure of gas, an Mcf, and compare it with the Btu content of a standard measure of oil, a barrel^{26/} the ratio of gas to oil is about one to six.^{27/} However, on the basis of Phillips' prices in the field, the ratio is about one to 33 for the year 1954. We can conveniently apply a factor to the Btu ratio that will have the effect of correcting its unreality and of avoiding imposing costs on gas consumers which should fairly be borne by the consumers of the ultimate products of the crude oil but also require gas to bear its proper share of the costs. Upon the basis of the considerations expressed above, and the record in this proceeding, we are of the opinion that the proper economic factor to be applied to the straight Btu content of oil to allocate Phillips' test year exploration costs is four, so that the cost relationship of finding one Mcf of gas to one barrel of oil will be about one to 24.

Our result is reached by an exercise of administrative judgment applied to the facts of the record as discussed above, p. ___, in connection with S.E.C. v. Chenery Corp., 332 U.S. 194. We have made a determination on the basis of the record, which, however, did not lead us to the precise conclusion. However, we are of the opinion that our allocation factor is as well, if not better, supported than our Seaboard rule that fixed costs should be classified fifty percent to the commodity charge and fifty percent to the demand charge.

^{25/} See Atlantic Seaboard Corp., et al., 11 FPC 43, 53; Canadian River Gas Co., 3 FPC 32, 61, affirmed as Colorado Interstate Gas Co. v. F.P.C., 324 U.S. 581, 586; Cities Service Gas Co., 3 FPC 459, 485, affirmed Cities Service Gas Co. v. F.P.C., 155 F. 2d 694, 704 (Ct. 10), certiorari denied, 329 U.S. 773.

^{26/} 42 gallons.

^{27/} The actual ratio ranges from 1 to 5.5 to 1 to 6, depending upon the Btu content of the particular oil and gas involved.

Our result might be different in other proceedings under different circumstances. In this case we are not determining rates for the future but are terminating proceedings not only with respect to the future but also, with two limited exceptions, for the past periods involved in the twelve Section 4(c) dockets here consolidated. In determining rates for the future we might arrive at a somewhat different result upon weighing the factors discussed here.

As may be observed, our result differs from the one to 33 ratio that would be obtained from the use of Phillips' test year sales realizations alone. It also differs from the approximately one to 34 ratio that would be obtained using the relative production costs alone. We do not reach our conclusion by modifying either production costs or sales realization, but rather by modifying the fundamental Btu relationship, because it is the Btu content that is the fundamental quality of fuels. Thus this economic factor is applied to the Btu or common fuel value of oil produced by Phillips to relate its Btu's to the joint exploration costs in the light of all of the circumstances developed in the record. The ratio we adopt to allocate Phillips' exploration costs thus gives more consideration to the relative Btu contents than does the relative test year realizations, or relative production costs, gives effect to the upward trend of gas production relative to oil in relation to the present level of exploration costs, and recognizes the increasing contribution that Phillips' current exploration costs are making to gas supplies as compared with oil. We believe that using such a ratio, and also fixing all gas rates on the basis of costs thus obtained will be of great benefit to consumers and producers alike. We consider the problem of bringing gas to market so important that we have not confined ourselves to a method that considers only historical relationships for the gas currently produced and leaves unresolved the cost basis for determining the rates for the additional gas that customers are demanding now, or will need in the near future.

The adjustment factor of 4 which we have applied to the Btu ratio of oil to gas, while based on judgment taking the above factors into consideration, is confirmed by the actual trend of prices. The record shows that the ratio of the price of a barrel of petroleum to an Mcf of gas at the well head produced by Phillips ranged from 39 to 1 in 1952 and 33 to 1 in 1954, down to about 29 to 1 in 1956. If this trend were extended, the ratio would reach our 24 to 1 in 1958. Similarly, the record shows that nation-wide the same ratio was 32.5 to 1 in 1952 and 27 to 1 in 1954. We may take notice that as shown by figures published by the Bureau of Mines, this trend, with certain ups and downs, continued, reaching 25.3 to 1 in 1958 and, if extended, would have reached a ratio of around 23 to 1 in 1959.

In carrying out the computation (as set forth in Appendix 6), we use an allowance for the Btu's in an Mcf of gas ranging from 1025 for the dry gas and San Juan gas to 1250 for the casinghead gas, while we use an allowance of 5800 Btu's for a barrel of oil and 5500 Btu's for a barrel of condensate. After computing the total amount of Btu's for the various types of gas and for oil and condensate based on volumes and employing the factor of four discussed above, we allocate the \$47,474,039 of exploration and development expenses 32.742 percent to gas and 67.258 percent to liquids. This amounts to 3.485 cents per Mcf of gas and 73.71 cents per barrel of liquids. We then allocate return and taxes amounting to \$10,839,194 on exploration and development investment between gas and liquids on the basis of the same percentages. The total exploration and development cost, including return for gas becomes 4.281 cents, while it amounts to 90.54 cents for liquids. The gas here includes condensate gas from which other liquids will be removed in the gasoline plants resulting in a further allocation of cost to liquids. The 4.281 cents per Mcf figure that we have reached for gas is a reasonable allowance for exploration and development based upon our knowledge of other companies in the industry. However, it will vary from company to company depending upon the relative amounts of the gas and liquids produced, the levels of output, the results of its exploration and the areas in which it operates.

In making our allocation of exploration and development costs, an adjustment was made for the proven gas reserves owned by Phillips in the San Juan Basin during the test year 1954 but sold in place to Pacific Northwest in 1955 with an overriding royalty retained. In making this adjustment, it was assumed that exploration and development costs in the test year were associated with production from the San Juan Basin as well as with production from Phillips' properties retained. Phillips, itself admits^{28/} that the San Juan royalties, of course, must bear some portion of current exploration expenses. What we have done is to normalize the gas royalty production of the San Juan Basin upward to reflect the normal recurring royalty production in subsequent years. Our treatment is consistent with the treatment of additional expenses arising from wage increases and our general policy of giving effect to known operating charges occurring within a reasonably short time after the close of the test year.

Although the actual production from the San Juan Basin during the test year was small, it was assumed that the volumes would be produced over an estimated life of 20 years, or 69,750,000 Mcf per year. Such a production period for gas wells is supported by the record and is consistent with our general requirements for the gas supplies prerequisite for granting certificates. Our computation results in allocating \$2,278,279 of exploration and development expenses to the San Juan gas, making a total of \$2,452,983 allocated to royalties compared with the examiner's \$7,558,299.

^{28/} Brief, p. 127.

ALLOCATION OF COSTS BETWEEN NATURAL GAS AND EXTRACTED LIQUIDS

As the examiner shows, Phillips sells residue gas and certain liquids, including gasoline, from the gasoline plants which it owns in the various fields. The question arises as to how to treat these sales in relation to cost of service. The first question is whether the gasoline plant operations should be considered jurisdictional, in which case the gasoline plant costs and revenues would have to be reflected in the jurisdictional gas cost of service, or whether the gasoline plant operations should be considered non-jurisdictional, in which case some method is necessary for allocating costs between the liquids separated in the gasoline plants and the residue gas. We are of the opinion that the examiner was correct in concluding that the gasoline plant operations are non-jurisdictional. The examiner goes into this matter thoroughly and his presentation, which we adopt, need not be repeated here. The record shows that the gasoline plant operations constitute a business for the benefit of Phillips rather than for the purpose of rendering the gas fit for pipeline transportation. The present situation differs from that involved in the City of Detroit case,^{29/} where the court held that the extraction operations were clearly within the jurisdiction of the Commission. In that case, Panhandle Eastern Pipe Line Company was both a producer and a pipeline company, and the court was impressed with the Commission's finding that the extraction of the heavier hydrocarbons did improve the efficiency of Panhandle's pipeline system along with the fact that the extraction process was incidental to the over-all pipeline transmission and resale operations. Here, on the other hand, Phillips is an independent producer without a pipeline system selling various products, oil, residue gas, gasoline etc. The production of gasoline and other liquids in the gasoline plants is not a mere incident to the sale of gas. It is an independent business, which is not subject to our regulation. There is thus only a question of the proper method of allocating costs to the separate products.

Our problem then, is to take the raw gas as it enters the gasoline plants with the exploration costs and the production costs assigned to it and determine what portion of the costs adherent to the raw gas is applicable to the residue gas leaving the gasoline plants. A number of methods to accomplish this were presented. A witness for the staff employed a relative value method which depended upon a market value for the gasoline and the gross realization from the sale of the residue gas. Wisconsin's witness presented what was known as the single marketable product method, in which he assumed in turn that the gas and then the liquids were waste products and obtained a justifiable cost of residue gas and a justifiable cost of liquids at the tail gate of the gasoline plants. In arriving at the justifiable cost of liquids, he substituted actual revenues as the

^{29/} City of Detroit v. F.P.C., 230 F. 2d 810 (CADC), certiorari denied 352 U.S. 829.

measure of their cost on the ground that the liquid revenues were lower than the combined cost of gas and liquids when assuming gas was a waste product. He eventually constructed a ratio of the justifiable cost of residue gas to the sum of the justifiable cost of residue gas plus the justifiable cost of natural gas liquids with a net result of allocating 28.40 percent of the costs to liquids and 71.60 percent to gas, based thus on all costs to the tail gate of the plants.

The witness for the Eastern Companies used a sales realization method, modified by adjusting downward the book revenues for natural gas liquids so as to eliminate plant processing costs and by adjusting upward Phillips' revenues from residue gas so as to reflect the same 1956 new contracts average price of 13.47 cents which he had used for the allocation of exploration costs under the RAR method. The examiner followed the sales realization method recommended by the Eastern Companies. However, he concluded that it should be corrected so as to exclude return and related taxes on gasoline plant investment in addition to plant processing costs. He reasoned that the price of the residue gas truly represents the value of the residue gas in the wet gas stream, but that in the case of the liquids, the price is substantially affected by the gasoline plant processing operation so that total gasoline plant costs should be deducted, including taxes and return. As modified by the presiding examiner, the sales realization method resulted in allocating 16.7881 percent of the raw gas costs to liquids.

Phillips employed a Btu method. It charged the investment and operating costs of the gasoline plants wholly to the liquids. There was thus left for allocation only the joint costs of the raw gas stream at the inlet of the plants. Phillips performed this allocation in steps by what it called the volumetric-Btu method. In the first step, an allocation of costs was made on the basis of the volumes of residue gas delivered by the plant compared with the reduction in the volume of the raw gas resulting from the returns of gas to the leases and the extraction of the liquids. In a second step, the allocation was adjusted to account for the loss of heating content in the residue gas as compared with the raw gas. Both reductions result in allocating 16.7202 of the relevant joint costs of the raw gas to liquids.

We are of the opinion that the Btu method is appropriate and simple for the allocation of costs to the products of the raw gas stream, and that it will not be necessary to bring in the factor of market price as we did in connection with exploration costs. We agree with the examiner that the single marketable product method of Wisconsin, which also makes use of revenues dependent on market prices, is highly artificial in addition to being subject to the defects of the realization methods. In support of the Btu method, we note first, that all of the products of the raw gas stream are in a gaseous state when entering the gasoline plants, so that the situation is different from that we face in allocating costs between oil and gas. Secondly, the extraction of these liquids reduces both the volume of gas and its Btu content. Furthermore, Btu measures a significant characteristic common to all of the components of the raw gas stream, that is the ability to produce energy. Oil, more than the natural gas liquids, has many uses other than fuel,

and so, as we have said, is not adaptable to a straight Btu method. By making cost allocated to residue gas dependent on Btu content, the operator of gasoline plants will not remove hydrocarbons from the gas stream unless they would interfere with the transportation of the gas or unless they would command a price out of all porportion to their Btu content when left in the gas stream. Unnecessary and costly removal of products from the raw gas will thus be avoided. The Btu method is useful and simple for our present purposes, and it reaches a reasonable result, not very different, as will be seen, from that reached by the examiner on the basis of his modification of the sales realization method.

As noted, Phillips carried out the Btu method in steps. What it did was to reduce the total volume of gas gathered, 687,145,852 Mcf by the raw gas sold from the system, 18,845,896 Mcf, a reduction of approximately 2.7 percent. It then reduced the balance of raw gas, 654,863,239 Mcf by the loss in the gasoline plants due to the extraction of the liquids and the return of gas to leases, a reduction of some 9.5 percent. Phillips applied the 2.7 percent to the total raw gas costs ³⁰/in order to allocate costs to raw gas sold. It also applied the 9.5 percent to the total raw gas costs to obtain an allocation of costs to liquids. We think that the 9.5 percent should have been applied to the costs, rather, of the gas remaining after the sale of the raw gas, for that is the way the 9.5 percent was derived.

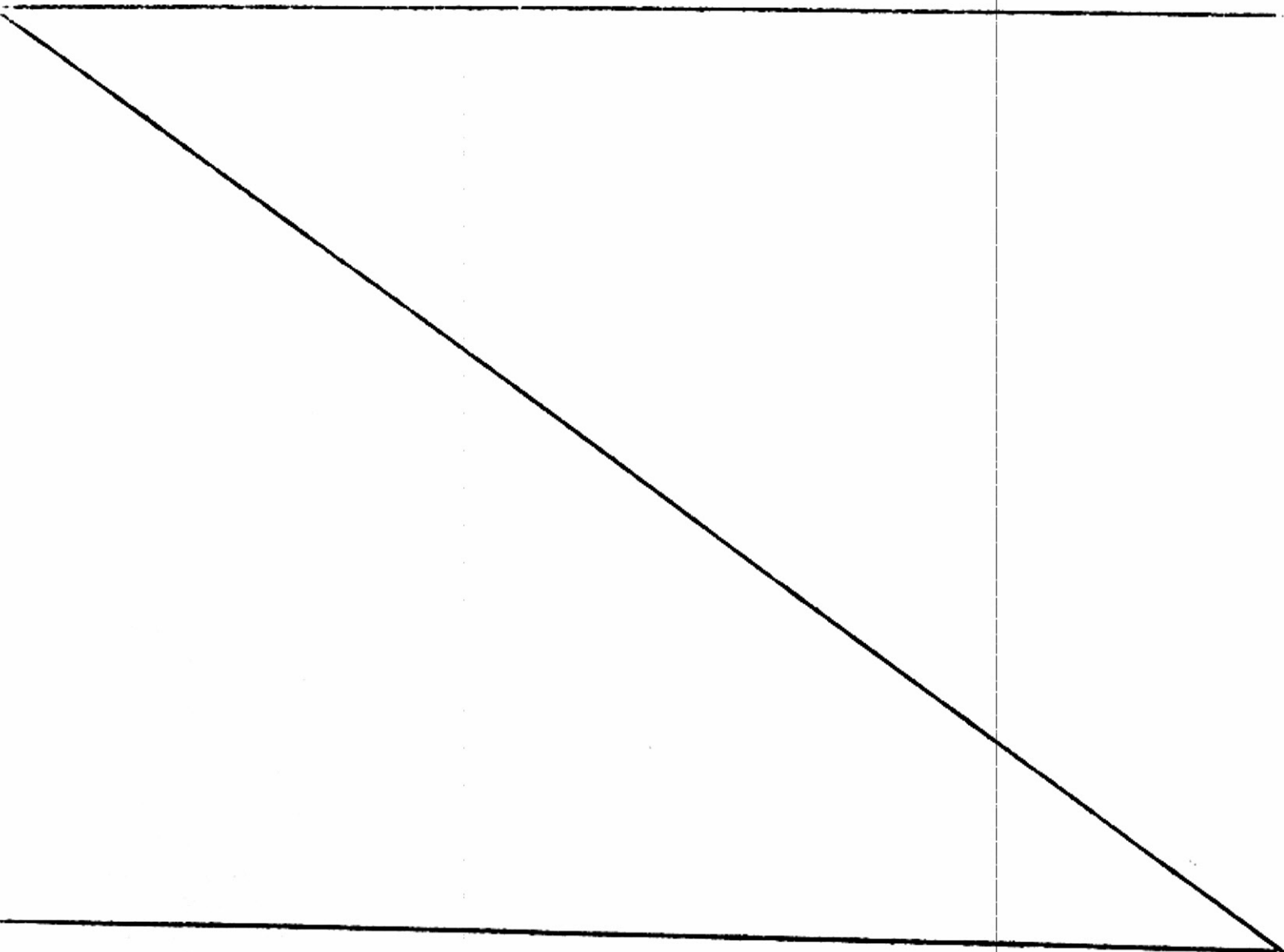
Phillips then computed a percentage reduction in Btu content per Mcf from raw gas to residue gas amounting to about 7.6 percent. ³¹/ It applied the 7.6 percent to the balance of raw gas costs after the deduction of the 2.7 percent and the 9.5 percent. The 7.6 percent represented an addition to the liquids cost, and the balance represented cost of the residue gas. As a final step, Phillips added back the costs allocated to raw gas sold to obtain a total cost of system sales, \$95,329,193, which it allocated on a volumetric basis 28 percent to non-jurisdictional sales and 72 percent to jurisdictional system sales.

Apart from the error that we believe Phillips made, we think that this step method is unduly complicated and without any necessary logical foundation. The allocation of raw gas costs to extracted liquids, raw gas sold and residue gas can be performed more simply on the basis of aggregate Btu.

³⁰/ Gas purchases, lease production--cost of service, and gathering system--cost of service.

³¹/ Btu content of inlet gas was 1151 Btu and of residue gas was 1063 Btu. $1151-1063=88$; $88 \div 1151=7.6$ percent.

The computation is performed in Appendix 9. This shows the total gas produced and purchased amounted to 783,675,122 Mcf. This is divided on the basis of volumes into field sales and total gas gathered, the latter amounting to 687,145,852 Mcf. The total gas gathered on the basis of volumes is distributed to raw gas sales in the amount of 18,845,896 Mcf and residue gas sales amounting to 592,282,042 Mcf, leaving 76,017,914 Mcf representing returns of gas to leases and the loss in volume resulting from the extraction of the liquids, etc. These amounts are then converted to Btu's using the 1151 Btu's per Mcf for the gathered gas and raw gas sales and 1063 Btu's per Mcf for the residue gas. From the Btu figures obtained percentages are derived, showing that of the total gas gathered, 17.6529 percent is allocable to extraction losses and returns to leases and 79.6045 percent to the residue gas sales. In the computation of the cost of service to be discussed below and shown in Appendix 10, the total cost of produced and purchased gas is reduced by the 17.6529 percent, representing the extraction liquids and returns to leases.



RATE BASE

The examiner used a 1954 year-end rate base, while the staff, Wisconsin, the Southern California Companies, and the Michigan Commission excepted, saying an average rate base should have been used. In past cases dealing with pipelines and electric companies we have traditionally used the average rate base although we have indicated that we might consider the year end balances in a proper case. United Fuel Gas Company, 12 FPC 251, 255; Otter Tail Power Company, 8 FPC 393, 400-401. The examiner has pointed to evidence showing that over a period of years Phillips' investment has been steadily increasing presumably, in part, because of the increasing costs of drilling for gas. In a company with such a rapidly expanding need for investment, we are of the opinion that the average test year rate base is not as representative of succeeding years as the year-end test year rate base, and therefore we agree with the examiner that year-end should be used. This does not mean that we shall not ordinarily require the average rate base in electric and pipeline rate cases.

In its exceptions, the staff objected to the inclusion in the rate base of \$17,765,332, representing undeveloped offshore leases, title to which was held by a subsidiary of Phillips during the test year. The subsidiary was dissolved in 1955 and the offshore leases were transferred to Phillips. The testimony indicated that, upon investigation, Phillips decided that the leases should be owned by the parent company. We have no difficulty in agreeing with the examiner that Phillips and its subsidiary should be treated together. In view of the necessity that all producers acquire additional reserves, we think that these reserves should be properly included in its rate base even though there was no production from them during the test year in the absence of a showing that holding these reserves without producing gas from them was unwarranted. In another proceeding where the record shows that leases owned by the producer had been developed but were being held without producing, it might be reasonable to exclude them from the rate base. For similar reasons, we agree that the examiner properly included in the rate base additional undeveloped leases, which with the offshore leases, totalled \$76,347,908 in the test year 1954.

A somewhat different problem is presented by the inclusion in the rate base of \$8,430,758, representing net investment in the San Juan producing leases which were transferred to Pacific Northwest Pipeline Corporation in November of 1955. Wisconsin and the Southern California Companies both except to the examiner's inclusion of this item. They argue variously that the jurisdictional revenues received from the properties during the test year amounted to only \$141,968 and that the revenues received from Pacific Northwest would be considered part of Phillips' non-jurisdictional business. We are of the opinion, however, that the examiner was correct in the position he took with respect to this item. The fact that reserves owned during the test year did not produce revenues is not sufficient ground to exclude them from the rate base, for reserves are often obtained and properly held for future needs because of conditions beyond the control of the producer.

Furthermore, the record shows that additions to Phillips' Gas Department properties in the year 1955 not only replaced the San Juan reserves dollar for dollar, but added some seven million dollars to the net investment over and above the depreciation and depletion that was recorded in that year. Therefore we can conclude that eliminating the San Juan reserves from the 1954 test year rate base would not make that rate base more representative of the future. Phillips is continually obtaining reserves, and at certain times it has disposed of reserves, so that the actual reserves at hand in the test year are appropriate for inclusion in the rate base.

Finally, the Michigan Commission contends that certain "general and service" assets should have been excluded from the rate base. These assets are referred to by the examiner as a hotel, a lodge, a hospital, patents and trademarks. While these items as applicable to the entire company amount to \$2,381,539, the adjustment as proposed by the staff would reduce the rate base by only \$324,055. The staff had employed a short-cut method of adjustment as did Phillips by a somewhat different means. The examiner did not make an adjustment for these items on the ground that whether the allocation was made by Phillips' method or the staff method, a proper computation would be too complicated for a de minimis item. He said that to arrive at a correct result, it would be necessary to make a precise calculation of the total net investment in every general and service assets item which could be regarded as proper investment in order to determine whether the short-cut method fully reflected the entire amounts properly chargeable for each of such legitimate items. We agree with the examiner that under the circumstances no adjustment is appropriate for this item.

The matter of working capital was not a subject of controversy in the exceptions. However, since we recompute the amount employed by the examiner some explanation is desirable. The examiner accepted Phillips' claim in the amount of \$29,841,420 ^{32/} and none of the other parties took specific exception thereto although Wisconsin's witness had stated that the amount was supported by insufficient evidence. The record, in fact, is deficient in support of Phillips' claim. The company's exhibit does set forth its amount for working capital divided into various categories^{33/} but does not show the method by which those amounts were reached.

32/ The examiner actually shows \$8,028,654 for the jurisdictional portion of the working capital.

33/ Production facilities, dry gas leases	\$6,281,978
Gathering facilities	3,209,581
Residue facilities	129,826
Oil production facilities, 100 percent oil leases	4,445,736
Oil and gas and cycling production facilities, joint product leases	15,774,299
	<u>\$29,841,420</u>

As set forth in Appendix 3, we compute an allowance for working capital in the amount of \$19,929,483. This amount is developed from evidence in the record using the methods that we have employed in previous cases dealing with electric companies and pipeline companies, and we see no reason why the same method may not be applied for the independent producers. Upon the basis of total direct, indirect and exploration expenses as allowed by us in this proceeding, less certain non-cash items, such as taxes and depreciation, we reach an amount for cash requirements, equivalent to operating expenses. One eighth of this, or 45 day's expenses we allow in the working capital. We then add an allowance for materials and supplies and prepayments to arrive at a total of \$19,929,483.

Upon the basis of the considerations expressed above and including the allowance for working capital, we find that the proper rate base for Phillips including the Natural Gas Department, the Oil and Gas Department, exploration and development, gathering system and gasoline facilities and residue system, amounts to \$424,775,939 as shown in Appendix 2.

RATE OF RETURN

The question of rate of return has been a matter of controversy in this proceeding as in many others, but there are involved here a number of considerations that we have not had to face in pipeline proceedings. The staff recommended a rate of return of 9 percent for Phillips, employing a method that utilized the earnings price ratio of Phillips equity securities and those of other companies. The examiner, in general, followed this method, but made a modification in the computation of the debt ratio and reached a rate of return of $9\frac{1}{4}$ percent. Phillips opposed the earnings-price ratio method, but modified this method and used it in conjunction with a method based on data published by the Internal Revenue Service and a method based on a comparison of Phillips' earnings on investment with the earnings on investment of producing companies of an allegedly corresponding risk. Using these methods, Phillips contended for a rate of return of approximately 12 percent, in addition to the benefits of the tax incentives discussed below or a rate of return of 17 to 18 percent if the retention of the tax benefits were denied.

In order to reach a fair rate of return for Phillips, we will not employ any formula rigidly. This is a matter which "depends upon many circumstances and must be determined by the exercise of fair and enlightened judgment, having regard for all relevant facts." Bluefield Water Works and Improvement Co. v. P.S.C., 262 U.S. 679, 692-693. The goal of our inquiry is stated in F.P.C. v. Hope Natural Gas Co., 320 U.S. 591, 603, where it is said that there must "be enough revenue not only for operating expenses but also for the capital costs of the business" including "service on the debt and dividends on the stock." The return to the equity owner must be "commensurate with returns on investment in other enterprises having corresponding risks" and "sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital." This is another situation where we must apply our judgment to a multitude of inter-related facts which cannot all be weighed mathematically, but nevertheless we must reach a decision and in doing so shall take such factors into consideration which appear to us relevant.^{34/}

Before discussing the specific question of what rate of return is fair and reasonable for Phillips we should consider the effect of certain tax

^{34/} See p. 13, citing S.E.C. v. Chenery Corp., 332 U.S. 194 and other cases.

incentives arising from the internal revenue code. Under the present tax law, provision is made for certain additional deductions which have the effect of lowering Federal income taxes payable. The question has arisen whether the benefit of those tax provisions should belong to Phillips, the taxpayer, or its customers and the consumers. That is, whether Phillips' cost of service should be computed without utilizing these tax deductions while at the same time taking advantage of them on its tax return. The examiner used actual taxes payable in his computation of cost of service. Phillips and certain of the interveners argued that the benefits should be retained by it.

The additional tax deductions in this proceeding relate to percentage depletion under Section 613 and intangible drilling and development costs under Section 263(c). These provisions have been discussed in previous decisions by us,^{35/} and it will only be necessary here to cover them briefly.

The percentage depletion incentive arises from Section 613 of the Internal Revenue Code as an alternate to the "reasonable allowance" standard of Section 611, which in practice means depletion on a cost basis. Under Section 613, the allowance for depletion on oil and gas wells is the lesser of either 27½ percent of the "gross income" or 50 percent of net income. An option to deduct as expense the intangible drilling and development costs under prescribed regulations is continued by Section 263(c) of the Internal Revenue Code of 1954. Proposed regulations provide that the owner of an operating mineral interest in oil or gas wells may at his option deduct, that is, "expense" intangibles, including amounts spent for labor, fuel, repairs, hauling and supplies in drilling wells, clearing ground and construction. In other words, instead of capitalizing the intangibles and depleting them over the life of the well, the producer may deduct them in the year incurred. See proposed Regulation § 1.612-4(a), (d), 603 C.C.H. 3552 and the corresponding regulations under the 1939 Code, Regulation 118 § 39.23(m)-16(a) (d). In our El Paso and United Fuel decisions, we concluded that when the percentage depletion and intangibles provisions are considered together in relation to the taxpayer's property as a whole, they result in a tax saving rather than a tax deferral. This is because the percentage depletion deduction depends upon revenues, so that there

35/ El Paso Natural Gas Co., 22 FPC 260, 265-269 reversed as El Paso Natural Gas Co. v. F.P.C., ___ F. 2d ___ (CA 5), August 2, 1960, No. 18022; United Fuel Gas Co., 23 FPC 127, 512.

is no decrease in deductions for depletion during the life of a gas lease because of expensing the intangibles in the first year. We further concluded in those two proceedings that it was the intention of Congress that the taxpayers should receive the benefit of these provisions. However, since the result was that the taxpayer would receive revenues without a corresponding expense, we said the tax savings should be considered in determining a fair rate of return.

In the present proceeding for the test year 1954, Phillips had a deduction for depletion in accordance with the tax statute that exceeded the book depletion by the amount of \$36,916,206, and a deduction for intangibles expensed in accordance with the tax statute that exceeded the amortization per books in the amount of \$7,868,517. Thus a total additional deduction results because of the two statutory tax incentives in the amount of \$44,784,723 and a tax saving of \$23,288,056, at the tax rate of 52 percent.

By opinion dated August 2, 1960 ^{36/} the Court of Appeals for the Fifth Circuit remanded the El Paso proceedings. The Court concluded that there was no statutory authority for the Commission to treat actual savings in taxes any differently than any other savings, that must be passed on to the consuming public. Therefore no amount representing tax benefits or tax savings could be included in the cost of service. The Court said, however, that "full effect must be given to the Congressional intent to make the several tax savings available to the taxpayer" but not in the form of "additional profits." The savings were available, the Court said, to make it so much easier for the natural gas producers in competition with other fuels and other industries to earn a fair return.

In the present proceeding the tax saving of \$23,288,056 amounts only to 6.63 percent on Phillips' well mouth properties. As will be seen, a fair return for Phillips would be at a higher rate than this under the contentions of any of the parties, but whether Phillips receives return as a tax incentive or as a specific allowance, does not affect the result. It must have a fair return on its well mouth, and all of its jurisdictional properties in any case. Therefore, we do not set forth the tax incentives as a specific item in the cost of service, for we are allowing a larger return than permitted by the tax incentives. We may now turn to a consideration of the factors relating to a fair rate of return apart from the tax incentives.

Phillips, as already noted, is a large company with assets of over a billion dollars, whose gas business is only a small fraction of the whole. Such a company is in a very strong position to raise capital. As a company with a continuing program of exploration and production it differs from other companies whose activities are sporadic or are merely holding reserves.

^{36/} El Paso Natural Gas Co. v. F.P.C., ___ F. 2d ___ (CA 5), August 2, 1960, No. 18022.

Phillips argues that it is a fallacy to apply to gas production operations a rate of return based upon the over-all cost of its capital because of the peculiarly risky nature of the oil and gas production business. It says that the cost of capital for the enterprise as a whole is less than the cost of capital for these risky operations. However, the financing of Phillips and its capital costs are affected by the nature and success of the whole business, and it would be impossible on this record to determine the cost of capital for part of its business. Furthermore, the evidence indicates that the companies that are solely producers have a higher market demand for their equity securities in relation to earnings than the companies with integrated operations. This is possibly because investors sought a hedge against inflation and invested in these stocks in order to acquire a share in raw materials in the ground. In any case, investors, according to the record, appear willing to accept a lower return from purely producing companies than from the integrated companies. Of course, as the examiner points out, the risk inherent in Phillips' producing operations is less than that for the producing operations of the large number of smaller companies. Nevertheless, production of gas creates risk in spite of the willingness of investors to purchase the securities of producers, and this risk must be taken into consideration in arriving at a fair rate of return. We should not base our findings wholly upon a passing tendency of investors.

The presentation by both Phillips and the staff are on the basis of Phillips' capitalization of December 31, 1955. In spite of the exceptions of the Southern California Companies, the capitalization on that date was more representative of the future than in 1954, for an issue of bonds was converted in 1955. Just as we made an adjustment for the related interest deduction for income tax purposes, we shall likewise adjust the capitalization ratio.

At the end of 1955 the company's actual debt ratio was 11.6 percent and the cost of its outstanding debt was 3.2 percent as shown by its capitalization:

<u>Long-term Debt</u>	<u>Amount</u>	<u>Cost to Company</u>
2 3/4 Debentures, 1964	\$ 28,050,000	2.82%
Subsidiaries' Loans 3-4% due 1963	81,000,000	3.36
Subsidiaries' Funded debt	9,120,000	3.00
Purchase obligation	775,583	3.00
Total long-term debt	\$118,945,583	11.6% 3.20%
 <u>Common Equity</u>		
Common Stock	\$455,838,132	
Earned Surplus	443,872,017	
Capital Surplus	1,431,827	
Total Common Equity	\$901,141,976	88.4%

There was no dispute about these figures, but the staff contended that Phillips' actual debt ratio and actual cost of debt should be adjusted to reflect as an interest-free loan an item of deferred Federal income tax liability in the amount of \$19,162,355, arising from the accelerated amortization provisions of Section 168 of the Internal Revenue Code. This would decrease Phillips' cost of debt to 2.76 percent. The examiner refused to make this adjustment, and we agree. The accelerated amortization provisions were to benefit the taxpayer, not the consumers. They represent an advantage bestowed by Congress to encourage the construction of emergency facilities, and we are not authorized to take away this advantage. City of Detroit v. F.P.C., 230 F. 2d 810, 822 (CA DC), certiorari denied, 352 U.S. 829. We cannot agree to the exception made by the Michigan Public Service Commission on this point.

In past proceedings dealing with the rates of both electric utilities and natural gas pipeline companies, we have always considered a number of factors in arriving at a proper allowance for common equity and finally a rate of return. In doing so, we have paid considerable attention to the earnings-price ratio of the company involved and other companies similarly situated.^{37/} The advantage of the earnings-price ratio as a critique is that it shows what investors will pay for the securities of the company involved in relation to contemporary earnings. But earnings-price ratios have pronounced drawbacks in some proceedings, including this one. Investors are interested in contemporary earnings, but they may be interested in other things as well, such as future earnings, possible discovery of large reserves, tax advantages, a hedge against inflation, so that the market price may reflect factors other than earnings. This is apparently true here, for the record shows that while the earnings on the book value of independent producers' equity have declined somewhat from 1949 through 1955, market prices of their stock have risen substantially. Furthermore, it is plain that potential investors in Phillips are not greatly influenced by Phillips' position in the gas business, since but six percent of its gross income comes from this source. While as we said in the Southern Natural case^{38/} the study of earnings-price ratios over a period of years may properly be used with judgment, together with other factors, in determining a reasonable allowance for equity, this is not a case where earnings-price ratios should be a controlling factor in arriving at a fair rate of return.

37/ Pennsylvania Water & Power Co., 8 FPC 1, 79-80, affirmed Pennsylvania Water & Power Co. v. F.P.C., 193 F. 2d 230 (CA DC), affirmed 343 U.S. 414; Michigan-Wisconsin Pipe Line Co., 13 FPC ___, Docket No. G-1678, July 30, 1954, mimeo p. 29; El Paso Natural Gas Co., 13 FPC ___, Docket No. G-2018, November 26, 1954; Southern Natural Gas Co., 24 FPC ___, Docket No. G-20509, July 8, 1960; Tennessee Gas Transmission Co., 24 FPC ___, Docket No. G-19983, August 9, 1960.

38/ Southern Natural Gas Co., 24 FPC ___, Docket No. G-20509, July 8, 1960.

While Phillips employed the earnings-price ratio method with adjustments, as already noted it relied on two other methods. One is the earnings-book value approach. By this method there is computed the ratio of earnings to book value of the common equity of comparable companies rather than the ratio of earnings to market price. The earnings-book value ratio is then applied to the equity capitalization. In employing this method, Phillips made use of a staff witness' list of companies, designated Class A, which are engaged solely in producing operations. In the seven year period, 1949-1955, Phillips noted that the average earnings-book value ratio for these companies was approximately 19 percent. Assuming an average borrowed capitalization of 14 percent and an interest rate of 4 percent, the 19 percent return on equity capital would result in an average rate of return for the Class A companies of approximately 17 percent, which Phillips contended would be about a reasonable allowance including tax incentives.

Although actual earnings related to book value cannot be decisive in determining a fair return, they constitute an important factor to be considered as showing what comparable companies are earning on the book value of their assets and the relation of Phillips' earnings to their earnings. This approach as employed by Phillips, however, mistakenly relies on the Class A producer companies whose operations differ from Phillips' integrated operations. The examiner notes that the earnings-book value ratios for the Class C integrated companies for the seven-year period used by Phillips amounted to only 15.3 percent, while if the five-year 1951-1955 period had been used, a ratio of only 14.8 percent would be obtained. If a group of 40 companies including both producers and integrated companies is examined, we find that the earnings over the five-year period is approximately 17 percent on their book value. Phillips' own earnings-book value ratio for the seven-year, 1949-1955 period was 12.1 percent and for the five-year, 1951-1955 period was 12.3 percent.

The other method proposed by Phillips as an alternative to the earnings-price ratio method was based upon Internal Revenue Service data. As stated by the examiner, Phillips' witness used statistical data, published by the Internal Revenue Service, showing balance sheet items and profit and loss statements. Using this data, Phillips' witness computed for the category of crude petroleum and natural gas production, a composite return to equity capital of 11.8 percent for the 1947-1953, seven-year period. Adding an estimated cost of financing of .75 percent, he arrived at a cost rate on common equity of 12.55 percent. This figure, combined with a 3.20 percent rate on debt, produced an overall rate of return of 11.46 percent. Adjusting to compensate for the risk of the "losers", the witness rounded out the rate of return to 12 percent. This method is based on data for companies which are very largely producers only and is subject to the further defect that it reflects only those companies reporting taxable income computed in a somewhat different way than would be net income for rate making purposes.

We may now consider the earnings-price ratio method as employed by the staff and as modified by Phillips. The staff witness determined an earnings-price ratio of 8.5 percent based on an average for the five-year period, 1951-1955. For this purpose he used a group of 41 companies, including as Class A, those companies which were strictly producers of oil and gas, as Class B, those companies which were producers of oil and gas and were also engaged in refining, and as Class C, the integrated companies producing, refining and marketing. To the ratio of 8.5 percent he added an allowance for the cost of financing of .75 percent and an investment factor of .75 percent over the "bare bones" cost of equity in order to enable the company to attract capital at reasonable cost, thus reaching a total allowance of 10 percent on Phillips' common equity.

In employing the earnings-price ratio technique, Phillips used the 20-company Class C group and the nine-year period, 1947-1955 to arrive at an earnings-price ratio of 12.9 percent. We agree with the examiner that the appropriate period was the five years, 1951 to 1955, because that reflects the more recent trend of earnings-price ratios. On the question whether to use the 20-company Class C group or the 41-company group, we are in agreement with the staff and the examiner that if the earnings-price ratio method is to be used, the 8.5 percent ratio applicable to the larger group should be employed. While Phillips itself is an integrated company, producing, refining and marketing, the record indicates that the companies in the Class C group are not strictly comparable to Phillips and, furthermore, we are regulating not all of the integrated operations but only the results of producing operations so that some additional weight should be given to such operations. On the other hand, we do not believe it would be appropriate to use the Class A producer group solely, for the financing of the producing operations presumably is affected by the fact that production is combined with refining and marketing. It is of some significance that the earnings-price ratios of the 41-company group for each year from 1947 to 1955 are very close to the earnings-price ratios of Phillips for those years and that the 5-year average for the 41-company group is 8.5 percent while the 5-year average for Phillips is the very close amount of 8.8 percent.

There appears to be no dispute about the staff witness' allowance of .75 percent for financing and this should be added to the earnings-price ratio. More difficulty is created by the allowance of an additional .75 percent over the "bare bones" equity cost. The staff witness testified that the market value of Phillips' common stock should be somewhere in the range from 1.12 or 1.15 times book value, to perhaps, around 1.40 or 1.50 times book value. He was of the opinion that 1.40 times book value would permit the company to maintain its financial integrity and to attract capital on reasonable terms and that if Phillips were given a rate of return somewhere around 9 percent, involving an allowance .75 percent for equity financing and .75 percent as an adjustment over "bare bones" equity cost, the market price would be around 1.40 percent of book value, all other factors being equal. There is no mathematical way to make such an allowance, but some allowance should be made above the "bare bones" cost of equity, and we think that the .75 percent used by the staff witness would be a correct adjustment to make. Phillips multiplied its unadjusted earnings-price ratio of 12.9

percent plus the .75 percent financing factor by the 1.40 market factor to arrive at an adjusted cost of common equity of 19 percent, which in turn resulted in an overall rate of return of 17 percent. This method is not only a mechanical method of solving a problem which is a matter for judgment, but arrives at a result which is not required by the demand of the market for Phillips' stock. The two .75 percent adjustments to the earnings-price ratio of 8.5 percent would bring the allowance for common equity up to 10 percent.

In our opinion the various statistical methods do not provide a complete basis for determining a rate of return for an independent producer of gas. It is clear that the risks of this business are greater than those of an electric utility or natural gas pipeline. While we cannot rigidly compare these companies with Phillips, for the circumstances and times are different, we do think that an allowance for common equity for a producer should be comparable to or greater than that for a pipeline company or an electric company. Some of these pipeline and electric cases are as follows:

<u>Name</u>	<u>Citation</u>	<u>Date</u>	<u>Common Equity</u>	<u>Overall Return</u>	<u>Equity Capitalization Ratio</u>
Pennsylvania Water & Power Co.	8 FPC 1	1-4-49	8.64	5.25	35.71
South Carolina Gen- erating Co. (based on parent South Carolina Electric & Gas Co.)	16 FPC 52	10-24-56	10.5	5.55	27.8
Michigan-Wisconsin Pipeline Co. G-1678	13 FPC ____	7-30-54	10.3	6.00	31.5 (pro forma)
El Paso Natural Gas Co. G-4769	13 FPC ____	11-26-54	14.4	6.00	19.0
Colorado Interstate Gas Co.	19 FPC 1012	6-21-58	12.85	6.00	22.6
Southern Natural Gas Co. G-20509	24 FPC ____	7-8-60	10.18	6.5	35.8 (pro forma)
Tennessee Gas Trans- mission Co. G-19983	24 FPC ____	8-9-60	10.12	6 1/8	29.5

One plain difference between Phillips and the companies listed here is that Phillips' capitalization consists of 88.4 percent equity and only 11.6 percent debt. This, of course, reduces the risk found in companies of thinner equity. While we believe that Phillips should be granted an allowance for common equity in excess of 10 percent our allowance will be limited by Phillips' high equity capitalization. By this we are not reversing the policy announced in previous cases of encouraging companies to improve their capitalization ratios, for in those cases we were generally dealing with much lower equity ratios as evidenced by the Michigan-Wisconsin and El Paso cases above.

At the hearing, and in its briefs, Phillips made an extensive presentation designed to show increasing demands for gas by consumers and the producers' increasing problem of supply. As stated by the examiner, the presentation attempted to show the rapidly increasing demand for natural gas, and the failure of discoveries to keep pace with the demand, the increasing depths of drilling resulting in increasing drilling costs, the rising exploration expenditures, the decreasing discoveries per foot of hole drilled, the declining ratio of net earnings to net investment in total gas and oil production and the increasing gas and oil ratios making the producer more dependent than formerly upon income from gas. As stated by the examiner, this evidence appears to relate to rate of return as well as the question of the percentage of exploration costs which should be allocated to gas.

It is clear enough that the national demand for gas is increasing. Phillips' witness estimated that the national demand would increase from 10 trillion cubic foot in 1955 to 15 trillion cubic foot in 1965. It is clear enough that the industry must continue to find additional reserves of gas and this must come from wells that are drilled ever deeper into the earth and some of them off the shore in the Gulf of Mexico. Of course, these deeper wells must be drilled at an increasing cost per foot of depth. It is also true, as Phillips contends, that oil and gas producers must have funds available as their present wells are depleted to drill new wells and find new reserves. Since these new wells will cost a great deal more than the old ones, the oil and gas producers are being faced with the constant necessity of plowing back into their business a substantial part of their revenue above depreciation and depletion accruals.

In view of these practical problems in the gas industry some allowance must be made in the rate of return to promote the continued exploration for and production of gas. The allowance of such an incentive is contemplated by the recent El Paso case^{39/} and the City of Detroit case.^{40/} The amount cannot be determined by any formula, and we can conceive of no evidence that would enable us to reach an amount other than by the exercise of our judgment with all the circumstances in mind.

39/ El Paso Natural Gas Co. v. F.P.C., ___ F. 2d ___, (CA 5), No. 18022, August 2, 1960.

40/ City of Detroit v. F.P.C., supra.

Upon the basis of all the factors discussed above it becomes necessary to determine an allowance for common equity for Phillips. We have noted the comparatively high earnings on equity of the integrated companies and the even higher earnings of the producers, offset by the fact that Phillips' own unregulated earnings on equity have been just a little over 12 percent. Phillips' Internal Revenue data with its disadvantages resulted in a cost rate on common equity of 12.55 percent. The earnings-price ratio method as employed by the staff and the examiner would result in an allowance of 10 percent. But it is clear that something more is needed if that method is employed in view of the allowances we have employed in pipeline cases and the need to encourage continued exploration for and production of gas. As against these factors tending to increase the return, we also bear in mind that Phillips is a large company and well established in the conduct of its gas business, its oil business and its other extensive operations. In these circumstances we think that an allowance for common equity of approximately 12 percent would be fair and reasonable.

Taking the cost of debt capital of 3.20 percent and the allowance for common equity of 12 percent, we compute a fair rate of return as follows:

<u>Allowance</u>		<u>Capitalization</u>	
Debt	3.2	11.6	.37
Common Equity	12.0	88.4	10.61
		<u>10.98 percent</u>	

The overall rate of return of 10.98 should be rounded off to 11 percent. As such we believe that it takes into account all factors necessary for determining a fair return and includes all that is required from the constitutional or the regulatory point of view.

As noted previously tax incentives will not be included in the cost of service. It appears from the data of record that the sum of the additional tax deductions for statutory depletion, intangible well drilling costs and interest expense would amount to \$46,680,450. This is approximately \$44,900 less than the return allowed of \$46,725,353 (See Appendix 2). Accordingly, we shall add an amount rounded to \$45,000 to the cost of service to provide an allowance for Federal income tax taking into consideration in this tax allowance the effect of a very small credit to working capital. Because of its small amount we do not show this credit as an actual deduction from working capital.

COST OF SERVICE

On the basis of the foregoing discussion in connection with the decision of the examiner, we determine Phillips' cost of service for its jurisdictional gas operations in the amount of \$55,548,054 or 11.309 cents per Mcf, as set forth in Appendix 10, subject to adjustment for Phillips' purchased gas costs, royalties, and gathering taxes. ^{41/}

The appendix shows the allocation of the cost of Phillips' own produced gas, in the amount of \$37,924,378, between non-jurisdictional field sales, jurisdictional field sales, and costs as delivered to gathering systems on the basis of volume. In the gathering category are included the \$28,180,164 portion of Phillips' produced gas costs, purchased gas costs in the amount of \$30,320,225, and gathering system and compressing costs in the amount of \$18,452,321. These costs are distributed between raw gas sales, liquids extracted, and residue sales on the basis of Btu's as previously discussed. The costs allocated to residue sales plus residue system costs and costs allocated to raw gas sales are then allocated between non-jurisdictional sales and jurisdictional sales. To the jurisdictional costs are added cost distributed to the jurisdictional field sales and regulatory commission expense to arrive at the total cost of jurisdictional service of \$55,548,054 or 11.309 cents per Mcf, subject to redetermination for purchased gas costs, gathering taxes and royalties.

^{41/} The examiner allowed increased royalties and gathering taxes in Phillips' cost of service as computed by him to reflect increased revenues resulting from his determinations. There is no question that such an adjustment is proper. If the cost of service determined by us were translated into revenues, we estimate that Phillips' royalties and gathering taxes would be increased by approximately \$1,500,000. Likewise, we estimate that Phillips' purchased gas costs as a result of the operation of the percentage-type casing-head contracts of its suppliers on an overall basis would be increased by approximately \$3,700,000. There is no purpose in making an exact computation here because the cost of service computed by us exceeds Phillips' revenues, and we are terminating all proceedings (with two irrelevant exceptions). However, if the computation were made on the basis of revenues reflecting our cost of service, our adjusted cost of service would exceed that computed by the examiner.

RATES

Having determined Phillips' cost of service, the next step would ordinarily be to alter Phillips' rates to reflect this cost of service. We are authorized in an investigation under Section 5(a) to determine rates prospectively and, of course, we can determine rates for the past periods with respect to the rate schedules involved in the Section 4(e) proceedings consolidated with this investigation. However, a very serious problem is before us.

We may first note the greatly varying contentions of the parties. In these proceedings Phillips contended for a uniform rate applicable to sales to all of its customers^{42/} subject to adjustment for point of delivery, pressure, dehydration and amount of sulphur (whether sweet or sour). The examiner used the company-wide method, but in their exceptions a number of the interveners objected vigorously and advocated variously other solutions, such as basing the rates on the existing contract rates or field prices. The staff advocated an area method of setting rates. On oral argument Phillips stated that it was not wedded to any particular system of rates as long as it recovered its total cost of service, and the State of Wisconsin and the California Commission which had objected to company-wide rates, admitted the record was insufficient to support other methods and withdrew their objections.

As already indicated, Phillips' operations are conducted in widely separated areas, and it produces gas of varying qualities and serves diverse customers under different conditions. Physically, Phillips owns gathering systems and holds leases in Kansas, in central Oklahoma, in the Panhandle of Oklahoma and Texas, in eastern New Mexico and western Texas along the Gulf Coast of Texas, in eastern Texas and other scattered localities. Its jurisdictional sales are represented by hundreds of rate schedules on file with this Commission.

The present proceeding involves an investigation of Phillips' rates on the basis of a record including evidence on the alternate test years 1954 and 1956 of which we chose 1954 in accordance with the decision of the examiner. From our knowledge of the industry, it is clear enough that costs and prices of gas in the field have greatly increased since that time. For instance, we have suspended approximately 95 rate changes filed by Phillips subsequent to the hearing in these proceedings. Some of its more recent filings involve substantial increases.^{43/} Therefore we do not deem it appropriate to prescribe

^{42/} Except with respect to percentage-type casinghead contracts.

^{43/} For example see the following increases:

Buyer	Docket No.	Amount Suspended	Effective Subject to refund
Michigan-Wisconsin P. L. Co.	G-19032	\$1,610,504	1-1-60
Panhandle Eastern P. L. Co.	G-19845	2,717,526	3-26-60
El Paso Nat. Gas Co.	G-18417	2,212,264	1-1-60
El Paso Nat. Gas Co.	G-20404	1,090,103	6-2-60
El Paso Nat. Gas Co.	G-20403	3,385,616	6-1-60

or require that Phillips file rates for the future based upon the present record. In fact, if this order provided for rates for the future effective in 1960 but based on the test year 1954, it might easily occur that the rates approved here would be lower than those approved in some of Phillips' suspension proceedings now before us. The consequence of this would be that Phillips would be required to decrease its rates in 1960 based upon an earlier test year, a result without reason or justice.

As a result we shall terminate the rate investigation proceedings in Docket No. G-1148 under Section 5(a). Phillips' customers will not be substantially injured, for Phillips' rate filings have been subject to our continuing surveillance and many large increases filed by it have been suspended under Section 4(e) of the Act and are currently the subject of proceedings before us. Furthermore, there is nothing to show that Phillips' contracts relating to Phillips' diverse conditions of sale are unduly discriminatory or preferential. Additionally its customers and consumers will receive the protection of our area pricing standards announced at this time. Phillips will not be injured, for we are thus leaving in effect its contract structure; it has had the privilege of filing increased rates and has done so in substantial amounts as already noted.

Our approach must be similar with respect to the twelve Section 4(e) proceedings consolidated herewith. Except in one minor case^{44/} all of these proceedings involve rates which have become effective after the test year, but have been superseded by other rates suspended by us in other proceedings. They must be considered in the light of the record in this case which is based on the cost of service method of regulation, but our conclusions here should not bind future determinations of Phillips' rates either in Section 4(e) proceedings or rate investigations under Section 5(a). The record in this proceeding indicates that these rates have produced revenues less than Phillips' cost of service during the periods that they were in effect. The cost of service determined by us of \$55,548,054 or 11.309 cents per Mcf is substantially in excess of Phillips' applicable jurisdictional revenues of \$45,568,291.

Although there is considerable diversity among the rates, there is nothing in the record to show that these past rates reflecting the different conditions of sale are unduly discriminatory or preferential. To allocate costs to each of them would require reopening the proceedings and the introduction of elaborate evidence. Little would be accomplished by way of adjusting them in any case since neither Phillips nor this Commission have authority under the Act to increase any of them retroactively above the filed level. On our part we would like to disturb area rate patterns as little as possible, particularly on a retroactive basis, having in mind the involved business arrangements that have arisen between the producers and their customers as the industry has developed. We thus find no purpose in continuing the Section 4(e) proceedings and will order that they be terminated with two exceptions discussed below.

^{44/} Phillips' Rate Schedule No. 68 for service to Cities Service Gas Co involving an increase of \$21,324, suspended by us in Docket No. G-8623 until May 1, 1955 is still in effect.

Our disposition made here avoids the necessity of dealing with the many questions raised in this proceeding as to Phillips' rates, but one question remains, and that is whether with respect to certain contracts Phillips was authorized to file increased rates. Under the Mobile case,^{45/} of course, a seller of gas may not file an increased rate unless contractually authorized. Phillips filed increased rates for service to El Paso, in Docket No. G-11217, to Michigan-Wisconsin in Docket No. G-10793, and to Panhandle in Docket No. G-10883 on the basis that the spiral clauses in its contracts authorized such increases. The examiner found that these clauses in Phillips' contracts with the three companies provided customer consent to increased rates above what would have otherwise been the contract level.

The spiral clauses provide that when the commodity index shall have increased more than a prescribed number of points and a general increase in the customer's rates shall have been put into effect, then Phillips' rates to the customer shall be increased in proportion. Certain of the California interveners contend in their exceptions that the spiral clauses are against the public interest and void, so that they cannot be used as a basis for consent to rate increases. While we do not approve of such clauses in principle, there is not sufficient basis on this record to hold them so derogatory of the public interest as to be void as a matter of law. Therefore, the spiral clauses in this proceeding provide a contractual consent to rate escalations. It may be recalled that the Supreme Court found no invalidity where the contract provided that the buyer should pay the rate the seller had on file with the Commission. United Gas Co. v. Memphis Gas Div., 358 U.S. 103. This contract with an unlimited right to file increased rates was not held void; neither have contracts with spiral escalation clauses in them been called void. Phillips Petroleum Co. v. F.P.C., 227 F. 2d 470 (CA 10), certiorari denied, 350 U.S. 1005; Kerr-McGee Oil Industries, Inc. v. F.P.C., 260 F. 2d 602 (CA 10). We emphasize, however, with the examiner that Phillips' costs have been determined in this proceeding independently of any spiral clauses. We need not require that they be eliminated, since Phillips has already agreed to do so.

El Paso argues that the spiral escalation clauses in its contracts with Phillips have not been activated and therefore do not form a basis for Phillips' rate increase filing in Docket No. G-11217, made as a result of El Paso's rate increase filing in Docket No. G-4769. El Paso contends in its exceptions, dated July 27, 1959, that the contracts clearly provide that Phillips would not be entitled to increased rates until by final decision El Paso's increased rates are finally determined. However, the contracts provide that the price for gas shall be adjusted "when revised rates shall become effective." El Paso's rates in Docket No. G-4769 were allowed to go into effect subject to refund on April 15, 1955, and we agree with the examiner that this provided customer consent to Phillips' rate filing in Docket No. G-11217. We also agree with him that the spiral clauses must be

^{45/} United Gas Company v. Mobile Gas Corporation, 350 U.S. 332.

given only tentative effect because the rate filing when it became effective was subject to Commission action and court review.^{46/} Thus, if the amount of the Phillips' escalation increase under the spiral clause, as established when El Paso's rates are finally determined, should be less than the amount of Phillips' proposed increase in Docket No. G-11217, the excess portion would be a unilateral increase barred by the Mobile doctrine and would have to be refunded.

These same conclusions are also applicable to the similar spiral escalation clauses in the Phillips-Michigan-Wisconsin contracts which are the subject of Docket No. G-10793 and the Phillips-Panhandle contracts which are the subject of Docket No. G-10883. Michigan-Wisconsin made no contention that the escalation clauses were not operative, but Panhandle contends that any increase granted Phillips in Docket No. G-10883 should be conditioned on the effect of a final order in Panhandle's rate proceeding in Docket No. G-2506. Therefore we shall leave pending Docket Nos. G-11217 and G-10883 until a final decision is made either by us or competent court in Docket Nos. G-4769 and G-2506, respectively. At that time Phillips may move that Docket Nos. G-11217 and G-10883 be terminated, and any necessary refunds may be ordered if the rates approved for El Paso in Docket No. G-4769 and for Panhandle in Docket No. G-2506 are not sufficient to permit Phillips under its contracts to file the increased rates involved in Docket Nos. G-11217 and G-10883. Of course, no other matter with respect to these two dockets will remain open.

Our dispositions here leave outstanding almost a hundred other suspension proceedings relating to Phillips' rates. We do not wish to prejudge those proceedings, but it would appear that on the basis of the present record that Phillips' costs probably exceed its revenues at least up through the year 1958, after which very substantial further rate increases were filed by Phillips. Therefore it may be reasonable to terminate a great many of these suspension proceedings, and we invite the filing of motions to this effect on the theory that little or nothing would be accomplished if hearings were held and a determination of Phillips' costs in each case were made. All parties to those proceedings would, of course, have opportunity to object to such motions. We believe this would be a reasonable step to take and it would have the effect of limiting proceedings dealing with Phillips' rates to the year 1959 and later.

^{46/} In Docket No. G-4769, the Commission issued its order determining El Paso's rates on August 10, 1959, 22 FPC 260, remanded by the Court. El Paso Natural Gas Co. v. F.P.C., ___ F 2d ___, (CA 5, August 2, 1960), Nos. 18022, 18120, 18124.

THE SETTLEMENT PROPOSAL

On April 8, 1960, Phillips filed a proposal to settle the present consolidated proceedings. The gist of its proposal is that the Commission would accept all of its contract rates involved and would terminate the various proceedings without refund. It contends that the prompt settlement of these extended proceedings without court review, otherwise almost certain, would be of great benefit to the Commission, its staff and all segments of the natural gas industry. It adds that the amounts collected by Phillips, subject to refund, are substantial, are increasing each month and may adversely affect Phillips' exploratory program. Phillips notes that under its settlement proposal the annual revenue to Phillips at April 1, 1960, contract prices, from the contracts which were the subject of the present hearing, amounts to \$70.8 million, compared to Phillips' claimed cost of service of \$92.3 million.

While it is possible that Phillips' proposal may not be unreasonable as a settlement, it was rejected by a number of parties to this proceeding including Southern California Companies, the State of Wisconsin and Public Service Commission of Wisconsin, Minneapolis Gas Company, the Eastern Companies, the Michigan Public Service Commission, and P.G. & E. The grounds given, stated variously, are that the settlement would give Phillips its entire filed rate increase, would be contrary to the findings of the examiner, would be an abdication of regulation, and would fail to settle questions of importance to the industry.

Because of these rejections the settlement proposal may not now be accepted as a settlement. It does not represent a new solution to the issues presented by this proceeding, but rather, acceptance of Phillips' present and past contract prices, many of which are now the subject of other proceedings. We therefore have no basis on which to accept it without agreement of the parties. However, if Phillips desires to renew its proposal or a similar proposal, it is free to do so, in the light of this opinion and the area pricing standards.

The Commission further finds:

(1) Phillips Petroleum Company is a natural-gas company subject to the provisions of the Natural Gas Act as determined by the Supreme Court of the United States in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, and the sales of natural gas for resale which are the subject of this order, are sales of natural gas in interstate commerce and are subject to the jurisdiction of the Commission.

(2) The total jurisdictional cost of service determined for Phillips in this proceeding is \$55,548,054, or an average of 11.039 cents per Mcf as set forth in the appendices attached hereto subject to adjustment of purchased gas costs.

(3) It is necessary and appropriate in the administration of the Natural Gas Act and good cause exists that the proceeding under Section 5(a) of the Natural Gas Act in Docket No. G-1148 and the proceedings in Docket Nos. G-3175, G-4333, G-6621, G-7773, G-8623, G-8695, G-8883, G-10359, G-10793, and G-11125, under Section 4(e) of the Act be terminated and Phillips' obligation to refund excess charges with respect to those dockets be discharged.

(4) It is necessary and appropriate in the administration of the Natural Gas Act that proceedings in Docket Nos. G-10883 and G-11217 remain open pending completion of proceedings in Docket Nos. G-4769 and G-2506 as provided below.

The Commission orders:

(A) The proceedings in Docket Nos. G-1148, G-3175, G-4333, G-6621, G-7773, G-8623, G-8695, G-8883, G-10359, G-10793 and G-11125 are hereby terminated and Phillips' obligation to refund excess charges with respect to those dockets is hereby discharged.

(B) Upon the issuance of a final Commission or Court decision in El Paso's pending Section 4(e) rate proceeding in Docket No. G-4769, Phillips shall file with the Commission a Motion Requesting Termination of its Section 4(e) proceeding in Docket No. G-11217. A determination will thereupon be made of the appropriate Phillips Section 4(e) rates in Docket No. G-11217, based upon the rate increase ultimately approved for El Paso in Docket No. G-4769, but in no event to exceed the rate filed in Docket No. G-11217. The Phillips Section 4(e) proceeding in Docket No. G-11217 will then be ordered terminated, subject to such appropriate refund order, if any, as may be warranted in the event that El Paso's proposed Section 4(e) rate increase in Docket No. G-4769 may not have been approved in toto.

(C) Upon the issuance of a final Commission or Court decision in Panhandle's pending Section 4(e) rate proceeding in Docket No. G-2506, Phillips shall file with the Commission a Motion Requesting Termination of its Section 4(e) proceeding in Docket No. G-10883. A determination will thereupon be made of the appropriate Phillips Section 4(e) rate in Docket No. G-10883, based upon the rate increase ultimately approved for Panhandle in Docket No. G-2506, but in no event to exceed the rate filed in Docket No. G-10883. The Phillips Section 4(e) proceeding in Docket No. G-10883 will then be ordered terminated, subject to such appropriate refund order, if any, as may be warranted in the event that Panhandle's proposed Section 4(e) rate increase in Docket No. G-2506 may not have been approved in toto.

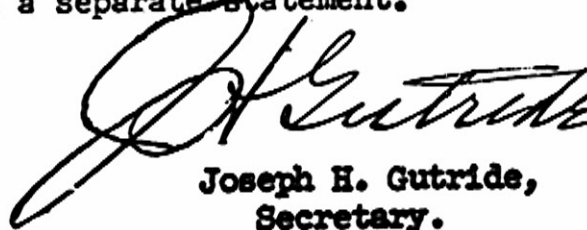
(D) Exceptions not granted herein are hereby denied.

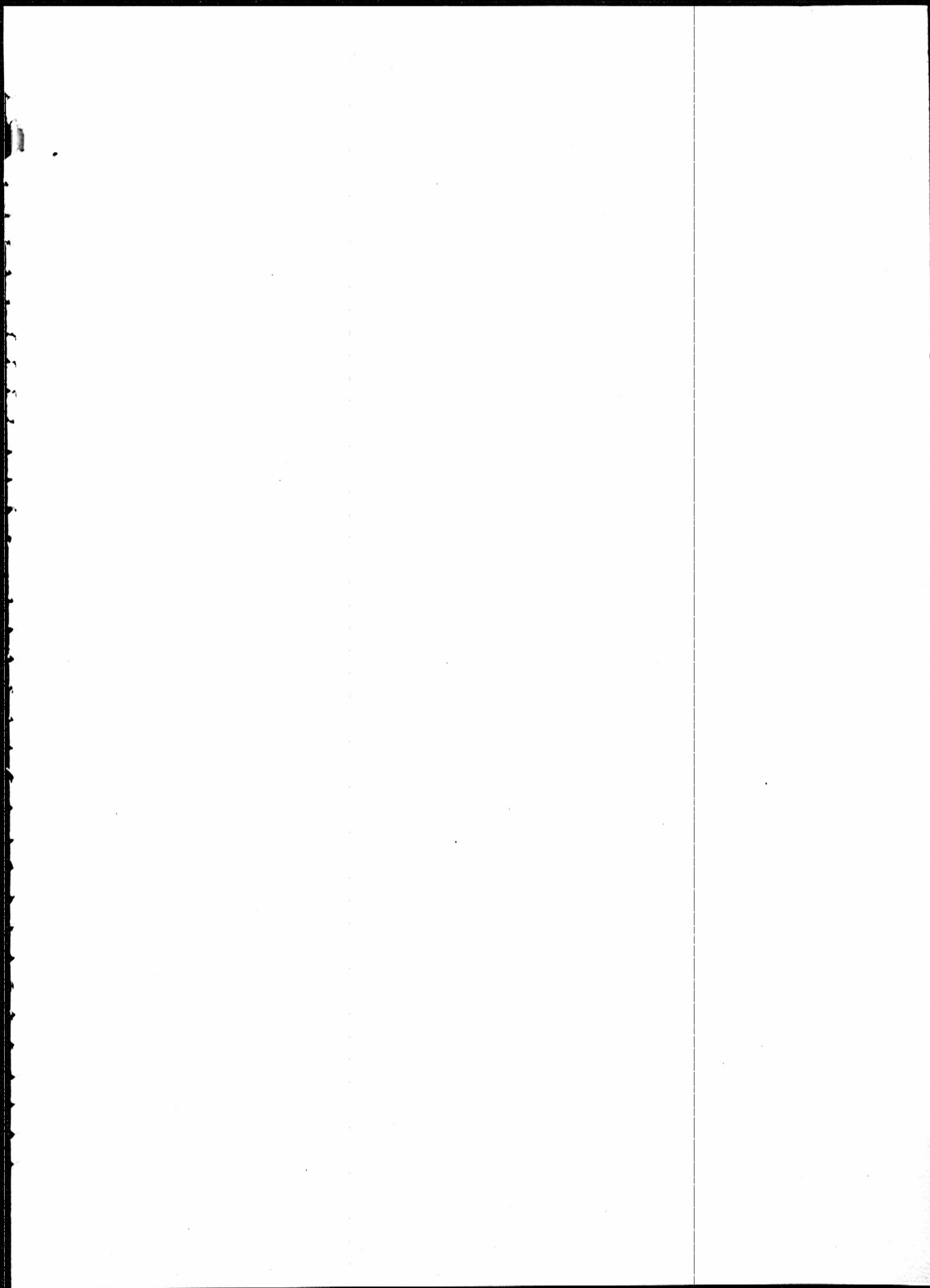
(E) The presiding examiner's decision is adopted as the decision of this Commission to the extent not inconsistent with this opinion and order.

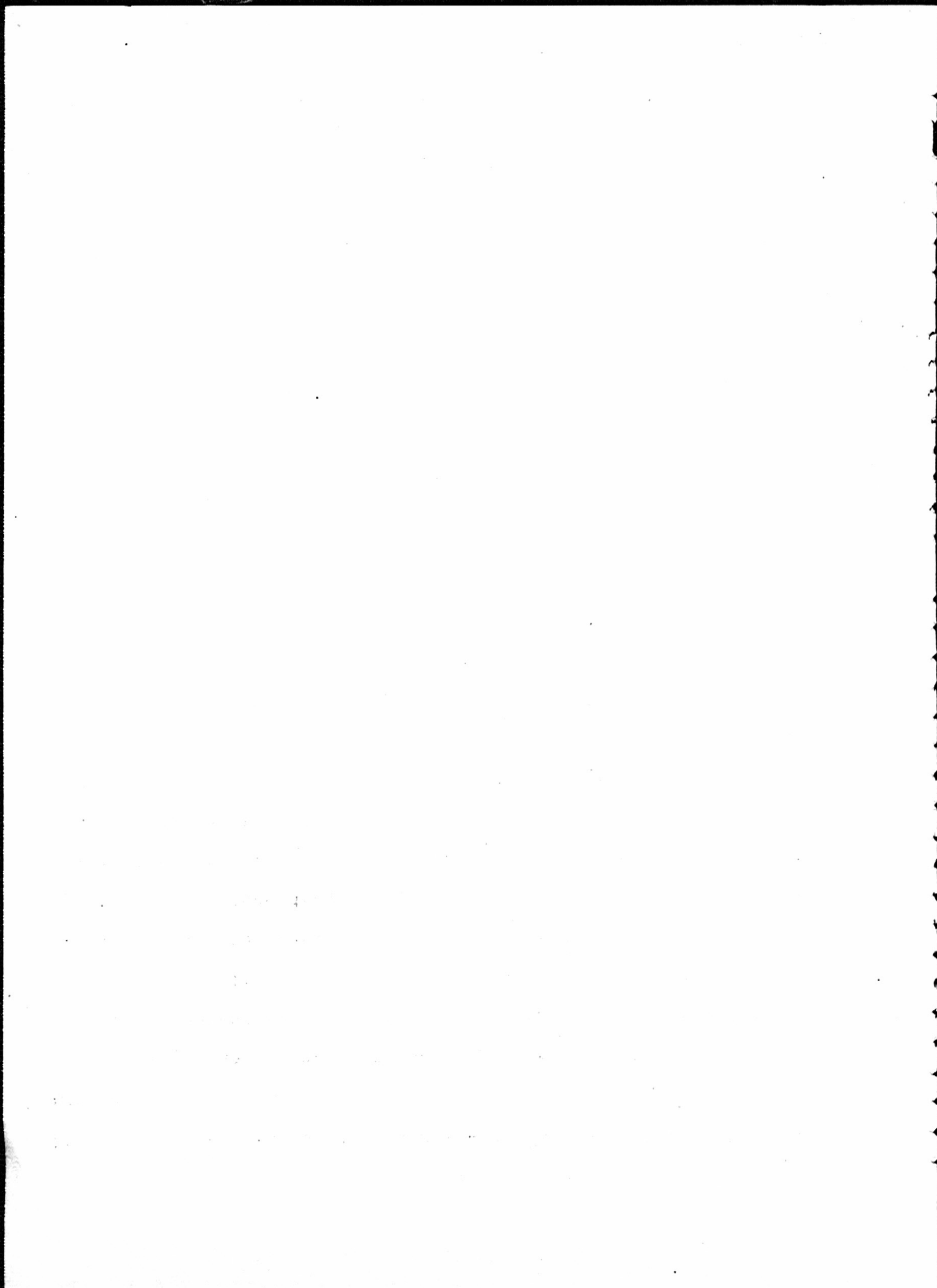
(F) The motion of the Mid-Continent Oil & Gas Association to file a brief amicus curiae is hereby granted.

By the Commission. Commissioner Kline, concurring in part and dissenting in part, filed a separate statement.




Joseph H. Gutride,
Secretary.





KLINE, Commissioner, concurring in part and dissenting in part:

I concur in the results reached in this case, namely, the dismissal of the Section 5 (a) proceeding instituted by the Commission against Phillips, and the disposition made by the Commission of the various Section 4 (e) rate increase cases. I do not concur in the cost of service determined for Phillips.

I also concur with the majority (1) that the traditional rate base cost-of-service method of fixing rates is generally neither an administratively practical or economically sound method to use to determine the rates of any individual independent producer, (2) that while ordinarily inappropriate, it can be used in this case to determine the justness and reasonableness of the rates charged by Phillips during the test year 1954 and the several years following as to which the 1954 test year can be considered representative, and (3) that we cannot in this proceeding fix Phillips' present or future rates.

I also concur in most of the methods of allocation and some of the rate-making principles adopted by the majority. I dissent vigorously to the method of allocation of exploration costs proposed and adopted by the majority and to certain of the other rate-making principles and findings contained in the opinion. The adoption of the method of allocation of exploration costs and other rate-making principles which I advocate would not affect the outcome of this case, although it would result in a different cost of service.

There have been many differences between my colleagues and myself on the various issues of this case, on how we should regulate the rates of independent producers in the future, and the extent to which we should discuss these matters in this opinion and in the statement of policy issued this day. Although I deem it entirely too vague and inadequate, I have joined in the statement of policy solely because it represents action rather than inaction.

I shall not at this time set forth my views on these various issues for to do so would result in further delay in the issuance of this opinion. I shall express myself fully on these various matters when we pass upon the petitions for rehearing which will undoubtedly be filed in this proceeding, or at some other appropriate future time.

Arthur Kline, Commissioner

PHILLIPS PETROLEUM COMPANY

Cost of Service
Year 1954

Description (1)	Total (2)	Oil & Gas Production Department						
		Natural Gas Department (3)	Total (4)	100% Oil Leases (5)	Joint Products Including Cycling (6)	Exploration and Development (7)	Gathering System & Gasoline Facilities (8)	Residue System (9)
DIRECT EXPENSE								
Operating Expense	\$ 25,872,563	\$ 457,300	\$18,281,379	\$ 7,811,373	\$10,470,006	\$ -	\$ 6,521,463	\$ 612,421
Other Lease Expense	980,725	119,024	831,296	175,601	655,695	-	28,153	2,252
Direct General Expense	13,154	-	13,154	-	13,154	-	-	-
Taxes	10,464,909	1,949,775	8,207,948	1,436,426	6,771,522	-	251,651	55,535
Depreciation	9,712,505	391,562	5,663,500	2,048,409	3,615,091	-	3,487,744	169,699
Retirements & Cost of Retirements	437,140	34,805	330,069	123,688	206,381	-	56,004	16,262
Depletion of Producing Leaseholds	3,123,518	389,459	2,734,059	717,570	2,016,489	-	-	-
Depletion of Intangible Development Costs	19,246,443	1,435,644	17,810,799	4,826,244	12,984,555	-	-	-
Miscellaneous Income	(1,082,490)	(20,989)	(94,377)	(58,279)	(36,098)	-	(962,769)	(4,355)
Net Profits Disbursements	575,638	-	575,638	25,189	550,449	-	-	-
Profit or Loss on Sale of Capital Assets	(125,535)	-	(125,535)	(137,267)	11,732	-	-	-
Total Direct Expense	69,218,570	4,756,580	54,227,930	16,968,954	37,258,976	-	9,382,246	851,814
Percent	100.000	6.872	78.343	24.515	53.828	-	13.555	1.230
INDIRECT EXPENSE:								
Direct General Expense	8,821,980	792,722	5,864,586	1,835,146	4,029,440	-	1,909,203	255,469
Indirect Overhead	11,284,363	2,052,812	7,622,773	2,385,318	5,237,455	-	1,488,631	120,147
Total Indirect Expense	20,106,343	2,845,534	13,487,359	4,220,464	9,266,895	-	3,397,834	375,616
EXPLORATION OPERATIONS:								
Exploration & Development Expense	47,474,039	-	-	-	-	47,474,039	-	-
Return on Exploration Investment at 11%	10,828,765	-	-	-	-	10,828,765	-	-
Federal Income Tax Allowance	10,429	-	-	-	-	10,429	-	-
Total Return & Tax Allowance	10,839,194	-	-	-	-	10,839,194	-	-
Total Exploration Operations	58,313,233	-	-	-	-	58,313,233	-	-
Return on Production Rate Base at 11%	35,896,588	5,688,681	24,094,258	5,385,704	18,708,554	-	5,666,764	446,865
Federal Income Tax Allowance	34,571	5,479	23,205	5,187	18,018	-	5,457	430
Total Return & Tax Allowance	35,931,159	5,694,160	24,117,463	5,390,891	18,726,572	-	5,672,241	447,295
Total Cost of Production, Gathering and Residue Systems	\$183,569,305	\$13,296,274	\$91,832,752	\$26,580,309	\$65,252,443	\$58,313,233	\$18,452,321	\$1,674,725

PHILLIPS PETROLEUM COMPANY

Rate Base and Return
Year 1954

Appendix 2
Docket No. G-114E, et al.

Description	Total	Natural Gas Department	Oil and Gas Production Department			Exploration and Development	Gathering System & Gasoline Facilities	Residue System
			Total	100% Oil Leases	Joint Products Including Cycling			
Net Investment Percent	\$404,846,456 100.000	\$50,201,147 12.400	\$209,530,777 51.756	\$46,109,957 11.390	\$163,420,820 40.366	\$92,069,847 22.742	\$49,202,860 12.154	\$3,841,805 .943
Gross Working Capital	19,929,483	1,514,138	9,507,932	2,850,985	6,656,947	6,373,469	2,313,335	220,609
Total Rate Base	424,775,939	51,715,285	219,038,709	48,960,942	170,077,767	98,443,316	51,516,215	4,062,414
Return at 11%	46,725,353	5,688,681	24,094,256	5,385,704	18,708,554	10,828,765	5,666,784	446,865
Federal Income Tax Allowance	45,000	5,479	23,205	5,187	18,018	10,429	5,547	430
Total Return and Tax	\$46,770,353	\$ 5,694,160	\$ 24,117,463	\$ 5,390,891	\$ 18,726,572	\$10,839,194	\$ 5,672,241	\$ 449,295
<u>Interest Calculated</u>								
Total Consolidated Net Assets 1954	\$799,360,230							
Interest Expense 1954	9,892,308							
Less:								
Interest Expense on Bonds Converted to Stock	6,149,231							
Total	\$ 3,743,077							
Interest Expense Allowance	3,743,077							
Total Consolidated Net Assets	799,360,230							
Interest Expense	1,895,730	235,071	981,147	215,914	765,233	431,125	230,397	17,990

= .00468259 per dollar of Consolidated Net Assets

Phillips Petroleum Company
Working Capital
Year 1954

Appendix 3
Docket No. C-1148, et al.

Description (1)	Total (2)	Natural Gas Department (3)	Oil & Gas Production Department			Exploration and Development (7)	Gathering System & Gasoline Facilities (8)	Residue System (9)	Remarks (10)
			Total (4)	100% Oil Leases (5)	Joint Products Including Cycling (6)				
Total Direct, Indirect, & Exploration Expenses	\$156,798,952	\$ 7,602,114	\$ 67,715,289	\$ 21,189,418	\$ 46,525,871	\$ 47,474,039	\$ 12,780,080	\$ 1,227,430	
Less:									
Taxes	10,548,016	1,949,775	8,207,948	1,436,426	6,771,522	83,107	251,651	55,535	Schedule Nos. 1 & 8
Depreciation	10,513,753	391,562	5,663,500	2,048,409	3,615,091	801,248	3,467,744	169,699	Schedule Nos. 1 & 8
Depletion of Producing Leaseholds	3,123,518	389,459	2,734,059	717,570	2,016,489				Schedule No. 1
Depletion of Intangible Development Costs	19,246,443	1,435,644	17,810,799	4,826,244	12,984,555				Schedule No. 1
Expired & Surrendered Leases	9,741,051					9,741,051			Schedule No. 8
Net Profits Disbursements	575,638		575,638	25,189	550,449				Schedule No. 1
Profit or Loss on Sale of Capital Assets	(125,535)		(125,535)	(137,267)	11,732				Schedule No. 1
Total Deductions	63,622,884	4,166,440	34,868,409	8,916,571	25,949,838	10,625,406	4,739,395	225,234	Schedule No. 1
Cash Requirements-Operating Expenses	\$ 83,176,068	\$ 3,435,674	\$ 32,846,880	\$ 12,272,847	\$ 20,576,033	\$ 36,848,633	\$ 9,040,685	\$ 1,002,196	
1/8 of Above (45 Days)	\$ 10,397,009	\$ 429,459	\$ 4,106,110	\$ 1,534,106	\$ 2,572,004	\$ 4,506,079	\$ 1,130,086	\$ 125,275	
Materials and Supplies	7,771,482	963,664	4,022,208	885,172	3,137,036	1,767,390	944,546	73,674	Exhibit No. 203
Prepayments-	1,760,992	121,015	1,379,614	431,707	947,907		238,703	21,660	Allocated-Net Investment
Total	\$ 10,929,483	\$ 1,514,138	\$ 9,507,932	\$ 2,850,985	\$ 6,656,947	\$ 6,373,469	\$ 2,313,335	\$ 220,609	Exhibit No. 208 Allocated-Direct Expense

Phillips Petroleum Company
Summary of Cost of Production
Direct and Allocated
Year 1954

	Natural Gas			Liquids		
	Direct	Allocated	Total	Direct	Allocated	Total
Total Direct Lease Expense	\$ 4,756,580	\$ 2,743,943	\$ 7,500,523	\$ 16,968,954	\$ 34,515,033	\$ 51,483,987
Total Indirect Expense	2,845,534	1,487,555	4,333,089	4,220,464	7,779,340	11,999,804
Return and Tax Allowance	5,694,160	4,316,731	10,010,891	5,390,891	14,409,841	19,800,732
Sub-Total Production	13,296,274	8,548,229	21,844,503	26,580,309	56,704,214	83,284,523
<u>Exploration Operations</u>						
Exploration Expense	-	13,090,967	13,090,967	-	31,930,089	31,930,089
Return and Tax Allowance	-	2,988,908	2,988,908	-	7,290,225	7,290,225
Sub-Total Exploration	-	16,079,875	16,079,875	-	39,220,314	39,220,314
Total	\$ 13,296,274	\$ 24,628,104	\$ 37,924,378	\$ 26,580,309	\$ 95,924,528	\$ 122,504,837
<u>Unit Costs</u>						
	<u>MCF</u>	<u>MCF</u>	<u>MCF</u>	<u>BBLS</u>	<u>BBLS</u>	<u>BBLS</u>
Volume	226,681,178	149,009,734	375,690,912	13,056,309	30,261,670	43,317,979
Unit Cost			10.095¢			\$2.83

PHILLIPS PETROLEUM COMPANY

Allocation of Joint Products Including Cycling on
The Basis of Relative Cost
Year 1954

Relative Cost Method			
Cost of Single Product Production			
Description (1)	Volume (2)	Amount (3)	Unit Cost (4)
DIRECT EXPENSE:			
100% Oil Leases	13,056,309	\$16,968,954	\$1.299674663
Natural Gas Department	226,681,178	4,756,580	.02098356838
INDIRECT EXPENSE:			
100% Oil Leases	13,056,309	4,220,464	\$.323250927
Natural Gas Department	226,681,178	2,845,534	.012553022
RETURN & TAX ALLOWANCE:			
100% Oil Leases	13,056,309	\$5,390,891	\$.41289548
Natural Gas Department	226,681,178	5,694,160	.02511968

Cost of Joint Product Production					
	Volume	Unit Cost	Amount	Percent	Allocated Amount
DIRECT EXPENSE:					
Liquids	30,261,670	\$1.299674663	\$39,330,325	92.6354899	\$34,515,033
Gas	149,009,734	.02098356838	3,126,756	07.3645101	2,743,943
Total			\$42,457,081	100.-	\$37,258,976
INDIRECT EXPENSE:					
Liquids	30,261,670	.323250927	\$ 9,782,113	83.947648	\$ 7,779,340
Gas	149,009,734	.012553022	1,870,522	16.052352	1,487,555
Total			\$11,652,635	100.-	\$ 9,266,895
RETURN & TAX ALLOWANCE:					
Liquids	30,261,670	.41289548	\$12,494,907	76.948634	\$14,409,841
Gas	149,009,734	.02511968	3,743,077	23.051366	4,316,731
Total			\$16,237,984	100.-	\$18,726,572

Summary			
Description (7)	Joint Products Including Cycling (8)	Allocated to:	
		Liquids (9)	Gas (10)
Total Direct Expense	\$37,258,976	\$34,515,033	\$2,743,943
Total Indirect Expense	9,266,895	7,779,340	1,487,555
Return & Tax Allowance	18,726,572	14,409,841	4,316,731
Total	\$65,252,443	\$56,704,214	\$8,548,229
Volume		30,261,670	149,009,734
Unit Cost		\$1.87	5.7374

Phillips Petroleum Company
Allocation of Exploration and Development Costs
Year 1954

Description (1)	Volumes (2)	Average Weighted Btu Ratio (Thousands) (3)	Total Btu (4)	Application of Economic Factor (5)	Adjusted Btu (6)	Per Cent (7)	Allocated Explor. & Development Expense (8)	Average (8)÷(2) (9)	Allocated Return on Exploration & Develop. Invest. (10)	Average (10)÷(2) (11)	Total Cost of Explor. Operations (12)	Average (12)÷(2) (13)
<u>Gas:</u>	<u>Mcf</u>							<u>\$/Mcf</u>		<u>\$/Mcf</u>		<u>\$/Mcf</u>
Casinghead	70,510,228	1.250	88,137,785	-	88,137,785	5.916	\$ 2,808,564	3.983	\$ 641,247	0.909	\$ 3,449,811	4.892
Condensate	78,499,506	1.150	90,274,432	-	90,274,432	6.061	2,877,402	3.666	656,964	0.837	3,534,366	4.503
Dry, Natural Gas Dept.	226,681,178	1.025 Est.	232,348,207	-	232,348,207	15.598	7,405,001	3.267	1,690,697	0.746	9,095,698	4.013
Sub-Total	375,690,912	-	410,760,424	-	410,760,424	27.575	13,090,967	3.485	2,988,908	0.796	16,079,875	4.281
(B) Overriding Royalty												
Natural Gas Dept.	5,347,080	1.025 Est.	5,480,757	-	5,480,757	0.368	174,704	3.267	39,888	0.746	214,592	4.013
(C) San Juan Adjustment	69,750,000	1.025 Est.	71,493,750	-	71,493,750	4.799	2,278,272	3.267	520,173	0.746	2,798,452	4.013
Total Gas	450,787,992		487,734,931	-	487,734,931	32.742	15,543,950	3.448	3,548,969	0.787	19,092,919	4.235
<u>Liquids:</u>	<u>Bbls.</u>							<u>\$/Bbl</u>		<u>\$/Bbl</u>		<u>\$/Bbl</u>
Oil	40,745,912	5.8	236,326,290	4	945,305,160	63.459	30,126,550	73.94	6,878,444	16.88	37,004,994	90.82
Condensate	2,572,067	5.5	14,146,368	4	56,585,472	3.799	1,803,539	70.12	411,781	16.01	2,215,320	86.13
Total Liquids	43,317,979	-	250,472,658	-	1,001,890,632	67.258	31,930,089	73.71	7,290,225	16.83	39,220,314	90.54
Total Gas & Liquids	-	(A) -	738,207,589	-	1,489,625,563	100.000	\$47,474,039	-	\$10,839,194	-	\$58,313,233	-

(A) Btu Ratio From Phillips Petroleum Co., Exhibit No. 310

(B) Calculation of Overriding Royalty, Natural Gas Department,
overriding Royalty, Natural Gas Department, Exhibit No. 316 \$ 447,818
Average Price Per Mcf, Natural Gas Department, Exhibit No. 359 8.375¢
Overriding Royalty of \$447,818 ÷ 8.375¢ Per Mcf = 5,347,080 Mcf

(C) Adjustment For, San Juan Sale to Pacific Northwest Pipeline Company
Estimated Volumes of San Juan Sale 1.395 Billion Cubic Feet
Estimated Life of Production 20 Years
Volume Assigned San Juan Sale
1.395 Billion Cubic Feet ÷ 20 Years = 69,750,000 Mcf Per Annum

Source of Volumes:
Exhibit No. 388, Schedule 27

Phillips Petroleum Company
Exploration and Development Expenses

Year - 1954

Description	Amount	Reclassification		Total
		Natural Gas Department	Oil and Gas Production Dept	
(1)	(2)	(3)	(4)	(5)
<u>Phillips Petroleum Company</u>	\$	\$	\$	\$
Drilling tool income	(7,308,354)	-	-	(7,308,354)
Clean out & miscellaneous tool income	(217,046)	-	-	(217,046)
Drilling tool expense	6,745,896	-	-	6,745,896
Clean out & miscellaneous tool expense	120,057	-	-	120,057
Undeveloped lease rentals	4,994,085	189,157	163,716	5,346,958
Taxes - exploration	83,107	-	-	83,107
Depreciation	801,248	-	-	801,248
Retirements - exploration	550	-	-	550
Cost of retirements - exploration	261	-	-	261
Dry holes - exploration and developmental	11,306,964	1,678,820	4,521,943	17,507,727
Dry holes - contributions	2,025,395	-	-	2,025,395
Expired and surrendered leases	9,479,898	234,721	24,751	9,739,370
Profit and loss from sale of capital assets	1,410	-	-	1,410
Geological, geophysical and land expense	-	3,749,475	8,801,529	12,551,004
<u>Total Phillips Petroleum Company</u>	<u>28,033,471</u>	<u>5,852,173</u>	<u>13,511,939</u>	<u>47,397,583</u>
<u>Phillips Chemical Company</u>				
Dry hole contributions	5,000	-	-	5,000
<u>West Edmond Oil Company</u>				
Undeveloped lease rentals	510	-	-	510
Dry holes - contribution	4,149	-	-	4,149
Expired and surrendered leases	1,682	-	-	1,682
	<u>6,341</u>	-	-	<u>6,341</u>
<u>Phillips Offshore Oil Company</u>				
Undeveloped lease rentals	65,115	-	-	65,115
<u>Total Exploration Expense</u>	<u>\$ 28,109,927</u>	<u>(A) 5,852,173</u>	<u>(B) 13,511,939</u>	<u>\$ 47,474,039</u>

(A) Exhibit No. 282, Page 8, Column (e), Lines 14, 15, 16 and 19.

(B) Land and geological expense from Exhibit No. 282, Page 12.
Undeveloped lease rentals, developmental dry holes, expired and surrendered leases from TR 10,138.

Phillips Petroleum Company

Summary of Gas Purchases

Year, 1954

Description (1)	Gas Purchases and Content Cost Statement Volume in MCF (2)	Adjustment to Calendar Year Basis Volume in MCF (3)	Total 1954 Purchased Volume in MCF (4)	1954 Purchased Volumes Adjusted To January 1956 Prices (5)	Unit Cost Per MCF (6) Col(5) ÷ Col(4)
System Gas Purchases From Leases in which Phillips Owns No Working Interest	333,364,465	3,009,457	336,373,922	\$ 23,411,181	6.960¢
System Dry Gas Royalties and System Dry Gas Purchases of Outside Working Interests, Applicable to Leases in Which Phillips Owns An Interest	38,501,603	192,892	38,694,495	3,444,639	8.902¢
System Casinghead Gas Royalties and System Casinghead Gas Purchases of Outside Working Interests, Applicable to Leases in Which Phillips Own An Interest	31,377,131	1,538,662	32,915,793	3,464,405	10.525¢
Total	403,243,199	4,741,011	407,984,210	\$ 30,320,225	7.432¢

Phillips Petroleum Co.
Gas Balance and Allocation Percentages
Year, 1954

Appendix 9
Docket No. G-1148, et al

Description (1)	MCF (2)	Distribution of Production		Total Gas Gathered (5)	Raw Gas Sales (6)	Extraction Losses, Returned to Leases, etc. (7)	Residue Gas Sales From Systems			Total Jurisdictional Gas Sales (11) Col.(4) & Col.(10)
		Less: Field Sales Non-Jurisdictional (3)	Jurisdictional (4)				Total (8)	Non-Jurisdictional (9)	Jurisdictional (10)	
<u>Gas Produced</u>										
Dry Gas	226,681,178									
Casinghead Gas	70,510,228									
Condensate Gas	78,499,508									
Total		375,690,912	31,370,014	65,159,256	279,161,642					
Per Cent	100.0000	8.3500	17.3438	74.3062						
<u>Gas Purchased</u>										
Outside Leases	336,373,922									
Outside Interest in Phillips Leases:										
Dry Gas	38,694,496									
Condensate & Casinghead Gas	32,915,793									
Total		407,984,210		407,984,210						
Total Produced & Purchased		783,675,122	31,370,014	65,159,256	687,145,852	18,845,896	76,017,914	592,282,042	166,262,345	426,019,697
Per Cent							100.0000	28.0715	71.9285	
Btu Per Mcf				1151	1151		1063			
Total Btu (Thousands)				790,904,876	21,691,626	139,617,439	629,595,811			
Per Cent				100.0000	2.7426	17.6529	79.6045			

Phillips Petroleum Company
Jurisdictional Cost of Service
Year 1964

Appendix 10
Docket No. G-1146, et al.

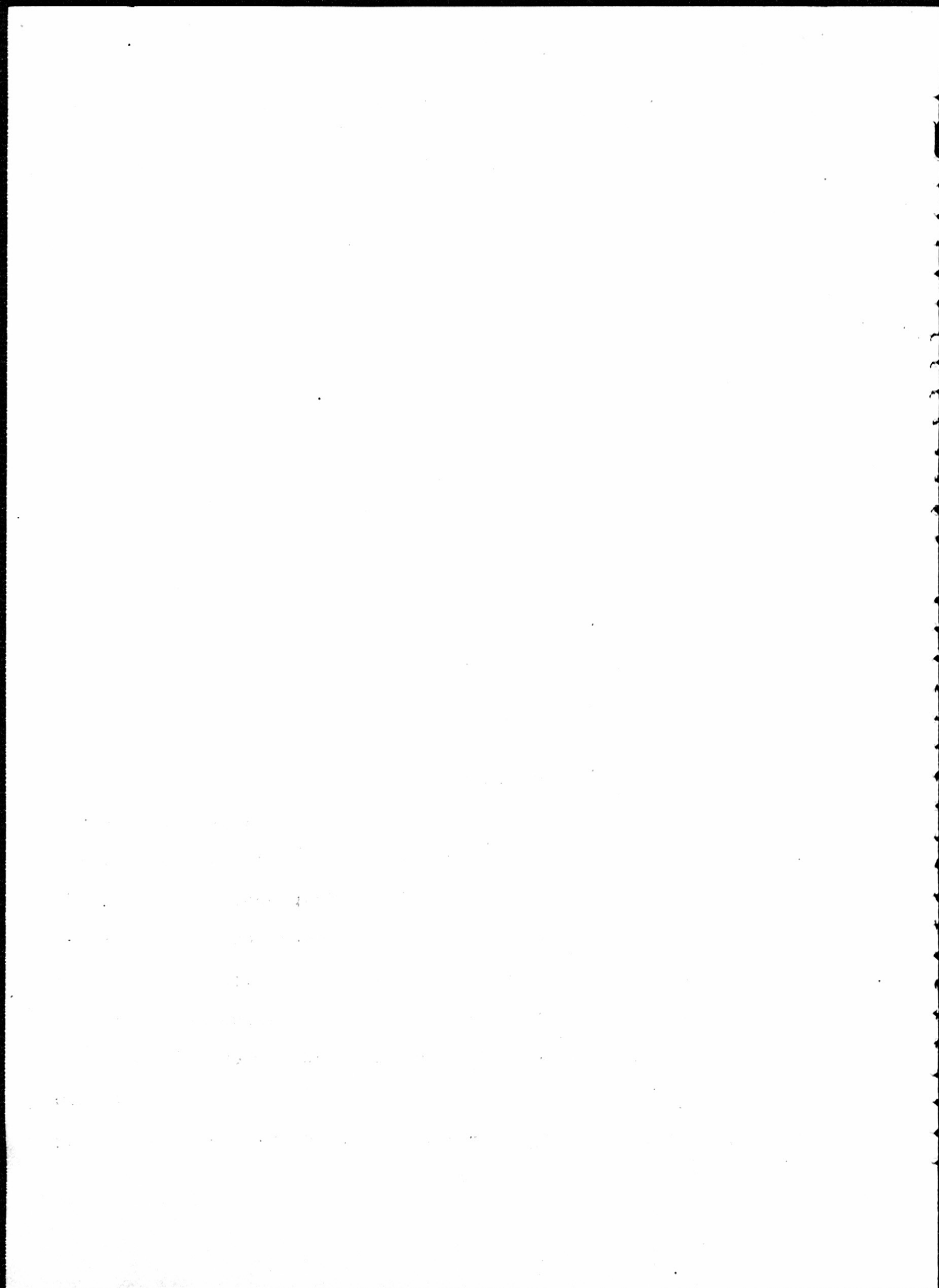
Description (1)	Volume (2)	Total Cost of Gas (3)	Distribution of Production & Exploration Costs			Raw Gas Sales (7)	Balance Col. (6)-Col. (7) (8)	Lease Liquids Extracted (9)	Total Cost of System Sales (10)	Sales	
			Non-Jurisdictional (4)	Jurisdictional (5)	Delivered to Gathering Systems (6)					Non-Jurisdictional (11)	Jurisdictional (12)
Per Cent		100.0000	8.3500	17.3438	74.3062	Col (6)x2.7426%		Col (8)x17.6529%	Col (6)-Col (9)	28.0715%	71.9285%
COST OF GAS PRODUCTION & EXPLORATION											
Direct and Allocated	375,690,912	\$ 37,924,378	\$ 3,166,686	\$ 6,577,528	\$ 28,180,164						
Purchased Gas	407,984,210	30,320,225			30,320,225						
Total Cost of Produced & Purchased Gas		<u>\$ 68,244,603</u>			<u>\$ 58,500,389</u>	\$ 1,604,432	\$ 56,895,957	\$ 10,043,786	\$ 48,456,603		
Gathering System & Compressing Facilities		18,452,321			18,452,321	508,073	17,946,248	3,166,033	15,284,288		
Residue System		<u>1,674,725</u>			<u>1,674,725</u>				<u>1,674,725</u>		
Sub-total		<u>\$ 88,371,649</u>			<u>\$ 78,627,435</u>	\$ 2,110,506	\$ 74,842,206	\$ 13,211,819	<u>65,415,616</u>		
Raw Gas Sales						<u>(\$ 2,110,506)</u>			<u>\$ 2,110,506</u>		
Total									<u>\$ 67,526,121</u>	<u>\$ 18,955,595</u>	<u>\$ 48,570,526</u>
Jurisdictional Sales From Systems (Column (12))											\$ 48,570,526
Jurisdictional Sales From Leases (Column (5))											\$ 577,528
Regulatory Commission Expenses											400,000
Total Jurisdictional Cost of Service											<u>\$ 55,548,054</u>

COST PER M.C.F.

\$55 548 054 ÷ 491 178 953 M.C.F.

11.309¢

1/ See page 9



UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

United States Court of Appeals
For the
District of Columbia

Before Commissioners:

Jerome K. Kuykendall, Chairman; Frederick Stueck
and Arthur Kline.

FILED NOV 9 1960

No 15461

Joseph W. Stewart STATEMENT OF GENERAL POLICY NO. 61-1

**Establishment of Price Standards to be Applied In Determining
The Acceptability of Initial Price Proposals and Increased
Rate Filings by Independent Producers of Natural Gas**

(Issued September 28, 1960)

This statement establishing rate standards for independent producers of natural gas is issued on our own motion and is based on our experience gained after six years of regulation of independent producers under the Natural Gas Act. By this statement and the appended area price schedules we will set standards for initial and increased rate filings by producers for the sale of natural gas into interstate commerce. These standards will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended.

Since the Supreme Court's 1954 decision in Phillips Petroleum Company v. Wisconsin, 347 U.S. 674, holding that under the Natural Gas Act the Commission has jurisdiction over the interstate transportation and interstate sale for resale of natural gas by independent producers, and that such producers are "natural-gas companies" under the Act, the Commission's regulatory task has increased enormously in size and difficulty. In contrast to the regulation of less than 200 pipeline companies prior to the Phillips case, under this decision Commission regulation extends to several thousand independent producers of natural gas. Although this producer segment of the natural gas industry differs from the pipeline transmission portion in fundamental particulars, its multiplicity of sales and services are now required to be covered by many thousands of rate and certificate filings under the Act.

This ever-growing volume of additional rate and certificate filings has placed an increasing burden not only on this Commission and other regulatory commissions, but on all those--consumers, producers, pipeline companies, and distributing companies as well--whose interests we must consider in administering the Act. It is essential, particularly in the interest of the consumer for whose protection the statute was enacted, that means be found for making the most effective use possible of the Commission's limited facilities in discharging the new and additional duties called for by the regulation of producers of natural gas. In our opinion, the price standards established by this statement will aid in effectively applying the

provisions of the Act to independent producers on a simple, clear and administratively feasible basis, and in a manner fair to all whose interests are affected by Commission regulation. Our many reasons for establishing these maximum acceptable rates as opposed to establishing rates based on a full cost-rate base hearing for every rate filing made by producers are set forth at considerable length in our opinion No. 338, Phillips Petroleum Co., Docket No. G-1148, et al., pp. 5 thru 12, issued on this date.

Some further explanation is required of certain aspects of these area rate levels. The geographical areas which we have used are convenient and well known. They are not necessarily in complete accord with geographical and economic factors which may be relevant to the establishment of pricing areas. As experience and changing factors may indicate, we will change or alter these areas from time to time in order to eliminate such inequities as may appear to exist because of our use of geographical boundaries.

In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas. Of necessity, we have not set forth the adjustments to these prices which must be made to take into account every possible provision of every contract which may affect the actual price, such as Btu adjustments, conditions of delivery, etc. The relevance of such adjustments to the basic contract price and the appropriate established price standard must be considered as each filing is made. As it becomes apparent that certain adjustments have general applicability in a specific area, the area price standard will be revised and set forth in greater detail with regard to the exact sale conditions to which the rate applies. We should, however, make it clear that these present price standards apply to pipeline quality gas as that term is generally understood in each area and, except for the Louisiana prices, are inclusive of all taxes.

Two price standards are set for each area. Initial prices in new contracts are, and in many cases by virtue of economic factors, must be higher than the prices contained in old contracts. For this reason, we have found it advisable to adopt two schedules of prices, one pertaining to initial prices in new contracts and one pertaining to escalated prices in existing contracts. It is anticipated that these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas.

It will be noted that we have omitted listing an initial price level for sales from Southern Louisiana and Mississippi. The proper initial price level for these areas is currently the subject of two hearings pursuant to Supreme Court decisions. Atlantic Refining Co. v. Public Service Commission, 350 U.S. 378; Public Service Commission v. F.P.C., 361 U.S. 195, F.P.C.

Docket Nos. G-11024, et al., and G-13143, et al., respectively. Clearly, in light of ~~these~~ cases, it would not be proper at this time for us to establish an initial rate level for these areas prior to a final determination of these cases.

These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level. As with the areas, the prices will be adjusted from time to time as such facts as may come before us compel such adjustments. For the present, and in the absence of compelling evidence calling for other action by us, proposed initial sales of natural gas by independent producers which include rates higher than those indicated in the appendix attached to this statement shall be denied a certificate or certificated only upon the condition that lower rates be filed, and all rate changes filed under existing contracts which call for a rate exceeding the indicated price level in the attached appendix to this statement shall be suspended.

Where a proposed price exceeds the indicated rate level and is therefore conditioned or suspended we will, in determining whether the higher price is justified, not necessarily consider only the financial requirements of the individual producer proposing the price but will consider all of the above elements relevant to the industry generally in the area concerned. Similar evidence will also be required from purchasers or their customers who object to any of the price levels or any specific price. Our determination will be in the nature of setting a price for the gas itself from any source questioned and not necessarily a price applicable solely to the party proposing some other price. In this connection we urge that all parties who have any interest in changing an area price join in such a proceeding leading to a determination of a proper revision, if any, in an area price or in the geographical area itself. As there will undoubtedly be numerous parties with an interest in such a proceeding full use should be made of pre-hearing procedures to reduce the factual issues and consolidate factual presentations to eliminate repetition and duplication of evidence. Because of the impossibility of giving detailed instructions for every proceeding, the precise course of each hearing and the admissibility and relevant weight of each type of evidence must be determined as hearings proceed and we expect to issue additional policy statements from time to time clarifying various aspects of these procedures and principles. The new area rate determinations resulting from such proceedings will represent final determinations of just rates for the areas involved as of the date of the decision and for prior periods.

By the Commission.



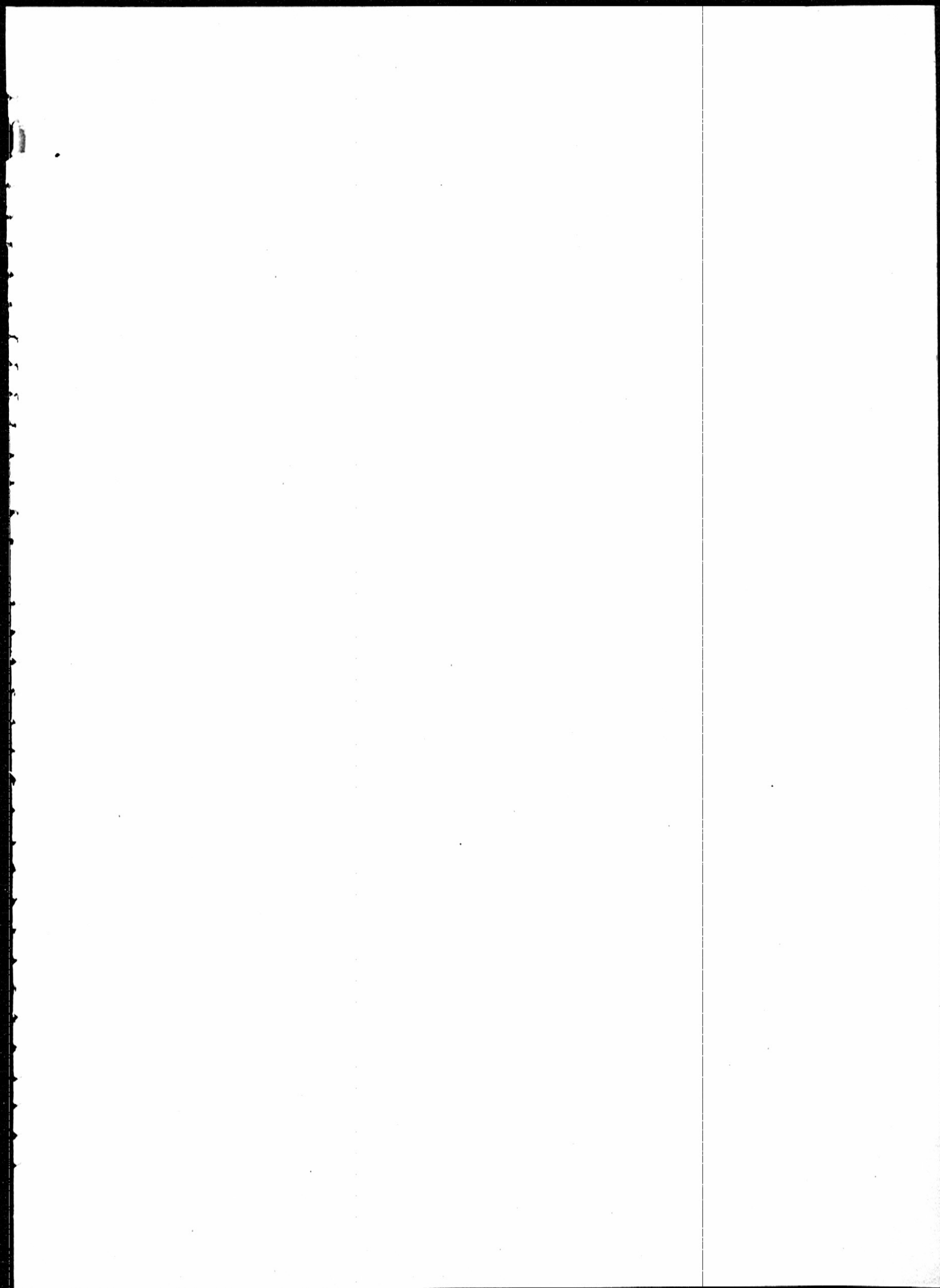
A handwritten signature in cursive script, reading "J. H. Gutride", is written over the printed name of the Secretary.

Joseph H. Gutride,
Secretary.

AREA PRICE LEVELS FOR NATURAL GAS
SALES BY INDEPENDENT PRODUCERS
(ALL RATES AT 14.65 PSIA)

APPENDIX A
(To Statement of
General Policy
No. 61-1)

<u>AREA</u>	<u>INITIAL SERVICE RATES/MCF</u>	<u>INCREASED RATES/MCF</u>
<u>Texas</u>		
District No. 1	15.0¢	14.0¢
District No. 2	18.0¢	14.0¢
District No. 3	18.0¢	14.0¢
District No. 4	18.0¢	14.0¢
District No. 5	14.0¢	14.0¢
District No. 6	15.0¢	14.0¢
District No. 7-b	14.0¢	11.0¢
District No. 7-c	16.0¢	11.0¢
District No. 8	16.0¢	11.0¢
District No. 9	14.0¢	14.0¢
District No. 10	17.0¢	11.0¢
<u>Louisiana</u>		
Southern	not determined	13.7¢ (14.0¢ at 15.025 psia)
Northern	16.6¢ (17.0¢ @ 15.025 psia)	13.7¢ (14.0¢ at 15.025 psia)
<u>Mississippi</u>	not determined	13.7¢ (14.0¢ at 15.025 psia)
<u>Oklahoma</u>		
Panhandle Area	17.0¢	11.0¢
Other	15.0¢	11.0¢
Carter-Knox	16.8¢	11.0¢
<u>Kansas</u>	16.0¢	11.0¢
<u>New Mexico</u>		
Permian Basin	16.0¢	11.0¢
San Juan Basin	12.7¢ (13.0¢ @ 15.025 psia)	12.7¢ (13.0¢ at 15.025 psia)
<u>Colorado</u>	14.6¢ (15.0¢ @ 15.025 psia)	12.7¢ (13.0¢ at 15.025 psia)
<u>Wyoming</u>	15.0¢	12.7¢ (13.0¢ at 15.025 psia)
<u>West Virginia</u>	26.8¢ (28.0¢ @ 15.325 psia)	23.9¢ (25.0¢ at 15.325 psia)



IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Public Service Commission of the
State of New York,

Petitioner,

v.

Federal Power Commission,

Respondent.

No. 15461

Before: Prettyman, Chief Judge,
in Chambers.
ORDER WITH RESPECT TO BRIEFS,
JOINT APPENDIX, AND RELATED PROCEDURES

Upon consideration of the motion filed by the parties, the Court orders as follows:

a. Petitioner, Public Service Commission of New York, shall print, serve, and file the joint appendix.

b. Dates for filing briefs, followed by printed joint appendix, and for tentative designations and final agreement on the portions of record to be printed in the joint appendix are fixed as follows:

April 18, 1960 -	Petitioners' brief or briefs to be served and filed
April 25, 1960 -	Tentative designations by petitioners to be served on all other parties
May 30, 1960 -	Respondents' brief or briefs to be filed and tentative additional designations by F.P.C. to be served on all other parties
June 6, 1960 -	Tentative additional designations by all other respondents, to be served on all other parties
June 20, 1960 -	Petitioners' reply brief or briefs to be filed and served and petitioners' final designations to be served on all other parties
June 27, 1960 -	Final informal agreement to be reached on the portions of the record to be printed in the Joint Appendix
July 11, 1960 -	Printed Joint Appendix to be filed and served.

c. Any intervenor objecting to the F.P.C. order or orders is deemed a petitioner and any intervenor aligned with the Federal Power Commission is deemed a respondent for purposes of this order.

d. This order is without prejudice to the filing or disposition of any motion to dismiss which has been or may be filed in this case.

e. Any party may join with any other party or parties in filing a single brief in this case.

f. In the briefs citations shall be made to the record as certified to this Court (e.g., "R. 000") instead of to the pages of the printed joint appendix; and the joint appendix shall be printed in accordance with the Rules of this Court except as follows:

The page numbers of the record as certified to this Court to be printed in bold-faced type in the center of the page, interrupting the text type at the precise points where each new certified record page begins;

Running heads to be printed in bold-faced type at the outer top corner of each page of the joint appendix to indicate the first and last record pages, any part of which appears on the respective left and right page of each facing pair of joint appendix pages;

The usual numerical pagination of the joint appendix to be printed in modern (i.e., light-faced) type in the center of each joint appendix page, either at the bottom or the top. All omissions from the record as certified shall be indicated by asterisks. Where portions of testimony are printed, the names of the witness and examining counsel shall be printed at the head. Where any part of an exhibit or other document is printed, its number or letter, and description, as shown in the certification of the record, shall be printed at the head. All portions

of the record shall be printed in the sequence in which they are paginated in the certification of the record.

g. Counsel for all parties shall severally and jointly endeavor to keep the size of the joint appendix to the minimum. Only such portions of the certified record shall be designated and printed in the joint appendix as have been cited in briefing and are necessary for the Court to read in order to resolve controverted issues. The final informal agreement on designations is to permit (1) minor adjustments and corrections not affecting the substance of the tentative designations; (2) withdrawals of parts of previous designations as consented to by all other parties; (3) supplementary designations to fairly provide the context for, or correct prejudicial omissions in, final designations by a petitioner where no written citation other than those already appearing in the briefs is substantially needed to lead the Court thereto, or where counsel making the supplemental citation state in writing their intention to supply the Court with citation thereto in their oral argument, and such supplemental designations otherwise satisfy the first two sentences of this paragraph. All designations shall be made by line and page of the beginning and ending of each portion.

h. Petitioners shall pay for the printing of the joint appendix (including all of the incremental cost of all portions, by whomever designated, of the additional 40 copies hereinafter referred to) dividing the net unreimbursed cost thereof among themselves as they shall agree. Reimbursement shall be made by parties other than the Federal Power Commission, respectively, for the pro rata costs of printing (except such 40 copies) the portions such parties designate which have not previously been designated by petitioners or the Federal Power Commission. If two or more parties supporting the order or

orders under review make duplicating designations of portions not previously designated, they may allocate the reimbursement of the cost of such portions among themselves as they may agree.

i. Six copies of each brief, joint appendix, or any printed motion or other printed pleading, and three copies of every other motion, designation, or pleading shall be served on every party; also 40 extra copies of the joint appendix shall be printed and made available at the incremental cost of printing such additional copies for any subsequent proceedings in the Supreme Court in these matters.

~~j. After the briefs have been filed, the parties will prepare and file an amendment to this order which amendment will deal with the questions to be presented for decision. If the parties agree on a statement of the questions, they will so say. If they are unable to agree on such a statement the petitioner may state the questions as he sees them and the respondent in its turn as it sees them. Such statements of the questions may be as then are stated in the respective briefs, or may be a revision of such statements prepared in the light of other briefs. When the amendment thus required has been filed, it will, if approved by the Court, become part of this order.~~

k. Pre-argument conferences and related procedures are dispensed with.

l. In the event of any disagreement arising herefrom the Court may, upon motion, resolve the same in accordance with the terms hereof, the applicable rules of the Court not in conflict herewith, and principles of law and equity.

Dated: January 13 1960

UNITED STATES COURT OF APPEALS
FOR THE
DISTRICT OF COLUMBIA CIRCUIT

*United States Court of Appeals
For the
District of Columbia Circuit*

FILED FEB 27 1960

Public Service Commission
of the State of New York,

Petitioner,

v.

Federal Power Commission,

Respondent.

Joseph W. Stewart
CLERK

No. 15,461

STATEMENT OF QUESTION
ON BEHALF OF CERTAIN INTERVENORS

In accordance with the order of this Court dated January 13, 1960, the Intervenor listed below propose the following statement of the question for decision in this matter:

Did the Commission abuse its discretion in refusing to impose a price condition in the certificates of public convenience and necessity issued to the producer-applicants?

Dated as of February 26, 1960.

Respectfully submitted,

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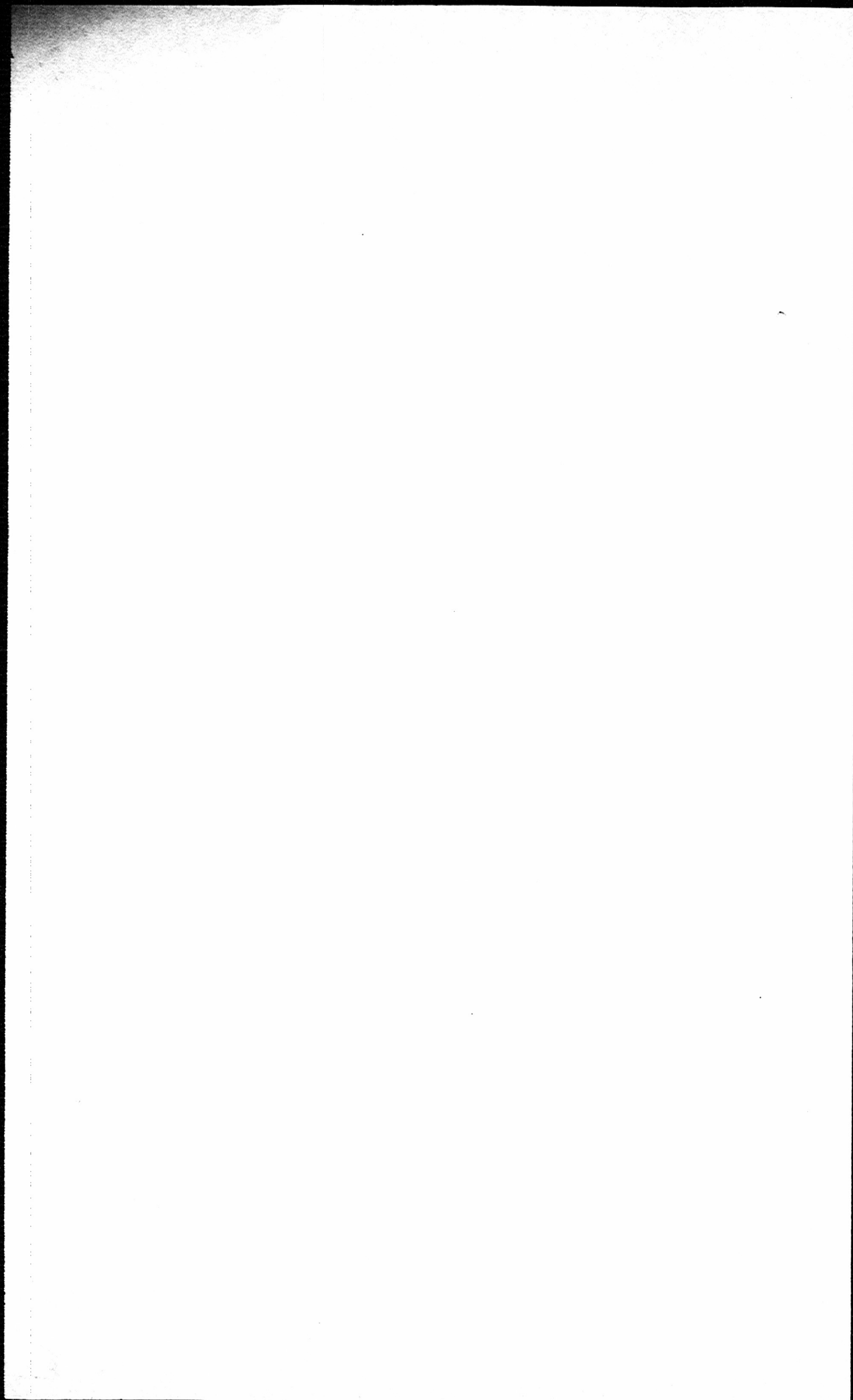
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UNITED STATES COURT OF APPEALS
FOR THE
DISTRICT OF COLUMBIA CIRCUIT

Public Service Commission
of the State of New York,

Petitioner,

v.

Federal Power Commission,

Respondent.

No. 15,461

CERTIFICATE OF SERVICE

I, John H. Pickering, a member of the bar of this Court, and attorney of record for Shell Oil Company, one of the movants herein, hereby certify that I have served this 26th day of February, 1960, the STATEMENT OF QUESTION ON BEHALF OF CERTAIN INTERVENORS as follows:

(a) Upon Petitioner by mailing a copy of said Statement to it, addressed as follows:

James A. Lundy, Chairman
Kent H. Brown, Counsel
Barbara M. Suchow, Counsel
Public Service Commission of the
State of New York
55 Elk Street
Albany 1, New York

(b) Upon Respondent by mailing a copy of said Statement addressed as follows:

Willard Gatchell, General Counsel
Howard E. Wahrenbrock, Solicitor
Joseph H. Gutride, Secretary
Federal Power Commission
441 G Street, N. W.
Washington 25, D. C.

(c) Upon all other parties who have been admitted to participate in the proceedings before the Respondent, by

mailing copies of said Statement to their counsel of record
as follows:

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JOHN H. PICKERING

John H. Pickering

RESPONDENTS MOTION FOR LEAVE TO SUBMIT
MEMORANDUM

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 15461

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL POWER
COMMISSION

JOHN C. MASON,

General Counsel,

HOWARD E. WAHRENBROCK,

Solicitor,

For respondent.

Federal Power Commission,

Washington 25, D.C.

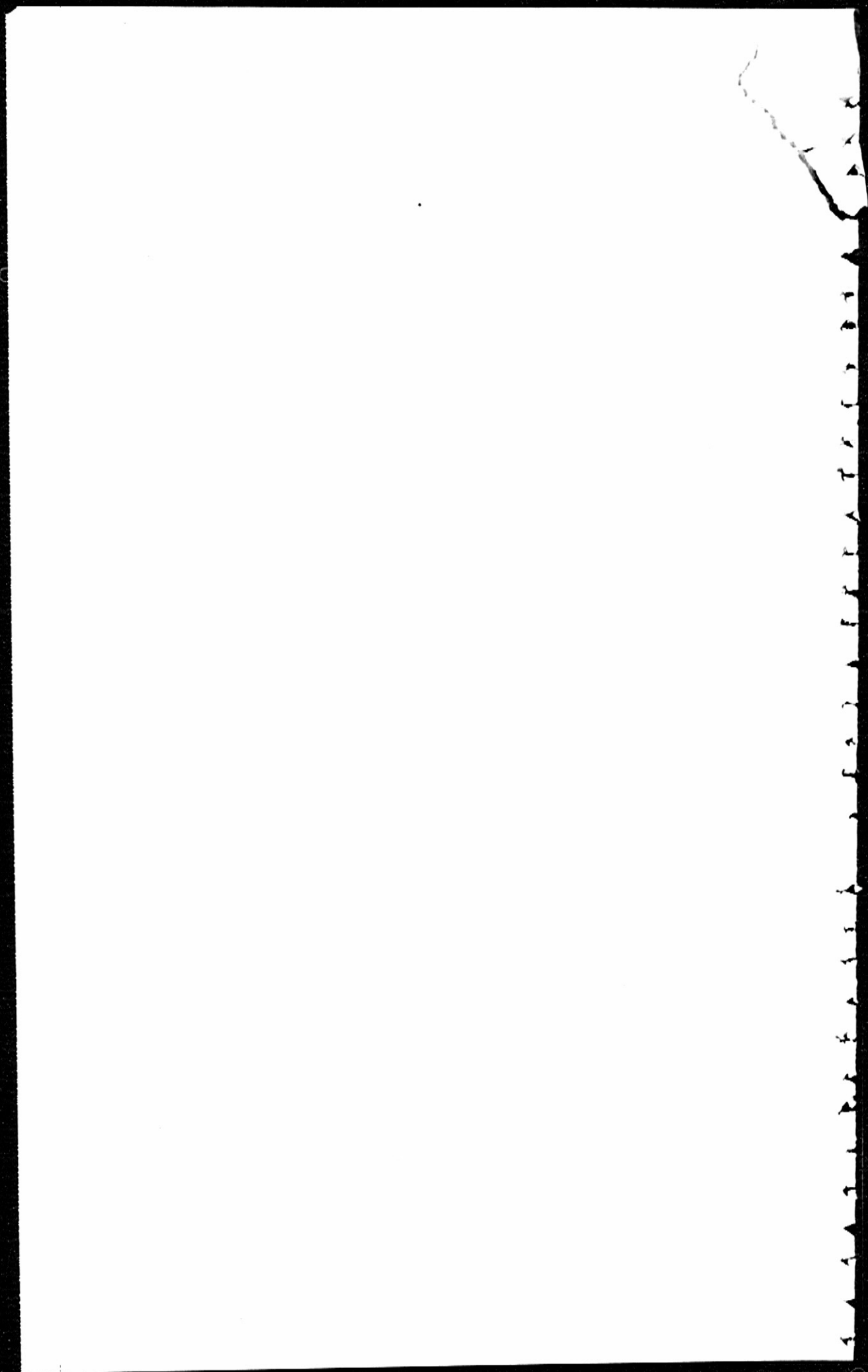
NOVEMBER 1, 1960.

*United States Court of Appeals
For the
District of Columbia Circuit*

FILED NOV 1 1960

Joseph M. Stewart

CLERK



United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 15461

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL POWER
COMMISSION

RESPONDENT'S MOTION FOR LEAVE TO SUBMIT MEMORANDUM

The respondent Federal Power Commission moves for leave to submit the following memorandum with respect to the bearing on the issues presented herein, of the statement of policy and amendment thereof, recently issued by the Commission.

Respectfully submitted.

JOHN C. MASON,

General Counsel,

HOWARD E. WAHRENBROCK,

Solicitor,

For respondent.

Federal Power Commission,

Washington 25, D.C.

NOVEMBER 1, 1960.

MEMORANDUM

We are asking leave to submit this short memorandum in order to discuss the bearing on the issues in this proceeding of the respondent Commission's Statement of General Policy No. 61-1 issued September 28, 1960 (together with erratum notice issued September 30) and The First Amendment to Statement of General Policy No. 61-1 issued October 25, 1960.¹

These statements, as we read them, corroborate our argument that Commission certification of these producer sales without any initial price condition reflected a Commission policy to "hold the line" on initial prices that fully conforms to the Supreme Court's *Catco* decision.² We showed that such "line" had been fixed at the then currently existing price level, absent a persuasive showing in a particular case fully justifying a higher price.

Our argument is that as of the date of the order complained of (August 10, 1959), such a Commission policy for new south Louisiana sales was revealed by the course of *ad hoc* Commission decisions reached in the light of the then currently prevailing market prices. Such prevailing prices are evidenced by the contracts which had previously come before the Commission in proceedings in which it had issued certificates. That actual price, we contend, was the factually significant economic fact, irrespective of any legal contingencies which petitioner might hope would affect some (but could not affect all) of the certificates which had been issued in south Louisiana.

The Commission has now itself expressly announced such a policy, without awaiting the case-by-case pricking out of "the line", for most of the pricing areas of the country. As we read the Commission's statements, the "policy" announced is substantially the same as can be gleaned from a sufficiently representative series of *ad hoc* decisions on certificate appli-

¹ We have heretofore sought promptly to bring to the Court's attention each of the documents referred to by our transmittals of September 29, October 1, and October 26, respectively. For convenience they are all reproduced as appendices to this memorandum, *infra*, pp. 4, 9, and 9.

² *Atlantic Refining Co. v. P.S.C. of New York*, 360 U.S. 378.

cations in each area; has the same practical (and limited) effect, in the light it throws on probable future decisions, as such a series of administrative agency decisions would have; and leaves the same latitude for future decisions.³

The Commission's last action announces the same price⁴ as we argue from previous Commission decisions on certificate applications already constituted "the line" in that area. As the Commission said in its last amendatory statement, this can not properly be construed as a pre-judgment of applications yet to be disposed of on records made pursuant to judicial remands. The Commission's original statement of September 28 sought to avoid a possible misunderstanding of the effect of its action on those cases by not announcing an initial price line in the Southern Louisiana-Mississippi area. In its deference to the courts the Commission may possibly have leaned over backwards. If so, the October 25 amendment, announcing a price line for that area, too, has now eliminated any possible misunderstanding of the effect of its statements of its policy upon our argument in this case.

Respectfully submitted.

JOHN C. MASON,
General Counsel.
HOWARD E. WAHRENBROCK,
Solicitor.

NOVEMBER 1, 1960.
WASHINGTON 25, D.C.

³ *Pottsville Broadcasting Co.*, 309 U.S. 134, 145-146; *Virginian Ry. Co. v. United States*, 272 U.S. 658, 665-666; *State Airlines, Inc. v. C.A.B.*, 84 AppDC 374, 382, 174 F. 2d 510, 518, reversed on other grounds, 338 U.S. 572; *Kentucky Broadcasting Corp. v. F.C.C.*, 84 AppDC 383, 385, 174 F. 2d 38, 40; *Churchill Tabernacle v. F.C.C.*, 81 AppDC 411, 413, 160 F. 2d 244, 246.

⁴ The price announced for south Louisiana is 21.5¢ per Mcf, exclusive of state tax reimbursement, at 15.025 psia. *Infra*, p. 10. That the 21.5¢ price is exclusive of reimbursement of taxes in Southern Louisiana is clear from the first statement of policy which explains that the prices "in each area * * * except for the Louisiana prices, are inclusive of all taxes" [Emphasis supplied]. *Infra*, p. 6.

APPENDIX

UNITED STATES OF AMERICA FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman;
Frederick Stueck and Arthur Kline.

STATEMENT OF GENERAL POLICY NO. 61-1

*Establishment of price standards to be applied in determining
the acceptability of initial price proposals and increased rate
filings by independent producers of natural gas*

(Issued September 28, 1960)

This statement establishing rate standards for independent producers of natural gas is issued on our own motion and is based on our experience gained after six years of regulation of independent producers under the Natural Gas Act. By this statement and the appended area price schedules we will set standards for initial and increased rate filings by producers for the sale of natural gas into interstate commerce. These standards will serve as a guide to us and to interested parties in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended.

Since the Supreme Court's 1954 decision in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 674, holding that under the Natural Gas Act the Commission has jurisdiction over the interstate transportation and interstate sale for resale of natural gas by independent producers, and that such producers are "natural-gas companies" under the Act, the Commission's regulatory task has increased enormously in size and difficulty. In contrast to the regulation of less than 200 pipeline companies prior to the *Phillips* case, under this decision Commission regulation extends to several thousand independent

producers of natural gas. Although this producer segment of the natural gas industry differs from the pipeline transmission portion in fundamental particulars, its multiplicity of sales and services are now required to be covered by many thousands of rate and certificate filings under the Act.

This ever-growing volume of additional rate and certificate filings has placed an increasing burden not only on this Commission and other regulatory commissions, but on all those—consumers, producers, pipeline companies, and distributing companies as well—whose interests we must consider in administering the Act. It is essential, particularly in the interest of the consumer for whose protection the statute was enacted, that means be found for making the most effective use possible of the Commission's limited facilities in discharging the new and additional duties called for by the regulation of producers of natural gas. In our opinion, the price standards established by this statement will aid in effectively applying the provisions of the Act to independent producers on a simple, clear and administratively feasible basis, and in a manner fair to all whose interests are affected by Commission regulation. Our many reasons for establishing these maximum acceptable rates as opposed to establishing rates based on a full cost-rate base hearing for every rate filing made by producers are set forth at considerable length in our opinion No. 338, *Phillips Petroleum Co.*, Docket No. G-1148, et al., pp. 5 thru 12, issued on this date.

Some further explanation is required of certain aspects of these area rate levels. The geographical areas which we have used are convenient and well known. They are not necessarily in complete accord with geographical and economic factors which may be relevant to the establishment of pricing areas. As experience and changing factors may indicate, we will change or alter these areas from time to time in order to eliminate such inequities as may appear to exist because of our use of geographical boundaries.

In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing

and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas. Of necessity, we have not set forth the adjustments to these prices which must be made to take into account every possible provision of every contract which may affect the actual price, such as Btu adjustments, conditions of delivery, etc. The relevance of such adjustments to the basic contract price and the appropriate established price standard must be considered as each filing is made. As it becomes apparent that certain adjustments have general applicability in a specific area, the area price standard will be revised and set forth in greater detail with regard to the exact sale conditions to which the rate applies. We should, however, make it clear that these present price standards apply to pipeline quality gas as that term is generally understood in each area and, except for the Louisiana prices, are inclusive of all taxes.

Two price standards are set for each area. Initial prices in new contracts are, and in many cases by virtue of economic factors, must be higher than the prices contained in old contracts. For this reason, we have found it advisable to adopt two schedules of prices, one pertaining to initial prices in new contracts and one pertaining to escalated prices in existing contracts. It is anticipated that these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas.

It will be noted that we have omitted listing an initial price level for sales from Southern Louisiana and Mississippi. The proper initial price level for these areas is currently the subject of two hearings pursuant to Supreme Court decisions. *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378; *Public Service Commission v. F.P.C.*, 361 U.S. 195, F.P.C. Docket Nos. G-11024, *et al.*, and G-13143, *et al.*, respectively. Clearly, in light of these cases, it would not be proper at this time for us to establish an initial rate level for these areas prior to a final determination of these cases.

These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial

action by the Commission and their use will not deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level. As with the areas, the prices will be adjusted from time to time as such facts as may come before us compel such adjustments. For the present, and in the absence of compelling evidence calling for other action by us, proposed initial sales of natural gas by independent producers which include rates higher than those indicated in the appendix attached to this statement shall be denied a certificate or certificated only upon the condition that lower rates be filed, and all rate changes filed under existing contracts which call for a rate exceeding the indicated price level in the attached appendix to this statement shall be suspended.

Where a proposed price exceeds the indicated rate level and is therefore conditioned or suspended we will, in determining whether the higher price is justified, not necessarily consider only the financial requirements of the individual producer proposing the price but will consider all of the above elements relevant to the industry generally in the area concerned. Similar evidence will also be required from purchasers or their customers who object to any of the price levels or any specific price. Our determination will be in the nature of setting a price for the gas itself from any source questioned and not necessarily a price applicable solely to the party proposing some other price. In this connection we urge that all parties who have any interest in changing an area price join in such a proceeding leading to a determination of a proper revision, if any, in an area price or in the geographical area itself. As there will undoubtedly be numerous parties with an interest in such a proceeding full use should be made of pre-hearing procedures to reduce the factual issues and consolidate factual presentations to eliminate repetition and duplication of evidence. Because of the impossibility of giving detailed instructions for every proceeding, the precise course of each hearing and the admissibility and relevant weight of each type of evidence must be determined as hearings proceed and we expect to issue additional policy statements from time to time clarifying various aspects of these procedures and principles. The new area rate determinations resulting from such proceed-

ings will represent final determinations of just rates for the areas involved as of the date of the decision and for prior periods.

By the Commission.

[SEAL]

JOSEPH H. GUTRIDE,
Secretary.

APPENDIX A

(To Statement of General Policy No. 61-1)

Area price levels for natural gas sales by independent producers

[All rates at 14.65 psia]		
<u>Area</u>	<u>Initial service rates/Mcf</u>	<u>Increased rates/Mcf</u>
Texas:		
District No. 1.....	15 cents.....	14 cents.
District No. 2.....	18 cents.....	14 cents.
District No. 3.....	18 cents.....	14 cents.
District No. 4.....	18 cents.....	14 cents.
District No. 5.....	14 cents.....	14 cents.
District No. 6.....	15 cents.....	14 cents.
District No. 7-b....	14 cents.....	11 cents.
District No. 7-c....	16 cents.....	11 cents.
District No. 8.....	16 cents.....	11 cents.
District No. 9.....	14 cents.....	14 cents.
District No. 10.....	17 cents.....	11 cents.
Louisiana:		
Southern.....	Not determined.....	13.7 cents (14 cents at 15.025 psia).
Northern.....	16.6 cents (17 cents at 15.025 psia).	13.7 cents (14 cents at 15.025 psia).
Mississippi.....	Not determined.....	13.7 cents (14 cents at 15.025 psia).
Oklahoma:		
Panhandle area.....	17 cents.....	11 cents.
Other.....	15 cents.....	11 cents.
Carter-Knox.....	16.8 cents.....	11 cents.
Kansas.....	16 cents.....	11 cents.
New Mexico:		
Permian Basin.....	16 cents.....	11 cents.
San Juan Basin.....	12.7 cents (13 cents at 15.025 psia).	12.7 cents (13 cents at 15.025 psia).
Colorado.....	14.6 cents (15 cents at 15.025 psia).	12.7 cents (13 cents at 15.025 psia).
Wyoming.....	15 cents.....	12.7 cents (13 cents at 15.025 psia).
West Virginia.....	26.8 cents (28 cents at 15.325 psia).	23.9 cents (25 cents at 15.325 psia).

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

ERRATA NOTICE

(September 30, 1960)

STATEMENT OF GENERAL POLICY NO. 61-1

(Issued September 28, 1960)

Page 3, line 3, [¹] delete "establish" and insert "announce"

Page 3, line 6, [²] change "prupose" to "purpose"

JOSEPH H. GUTRIDE,
Secretary.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman;
Frederick Stueck and Arthur Kline.

FIRST AMENDMENT TO STATEMENT OF GENERAL POLICY NO. 61-1

(Issued October 25, 1960)

In our Statement of General Policy No. 61-1, issued September 28, 1960, we did not announce a price level for initial sales from Southern Louisiana and Mississippi for the reason therein given. Subsequent to the issuance of our statement, we have found that the great number of proposed sales from this area involved in certificate proceedings renders it imperative that a price level be announced. The large amounts of gas vitally needed from this area for widespread interstate markets cannot be given consideration and certification consistent with the sales from other areas under our new policy unless all parties including our staff, producers and purchasers are aware of exactly what initial price level we feel is presently appropriate.

¹ Page 6, line 36, *infra*.

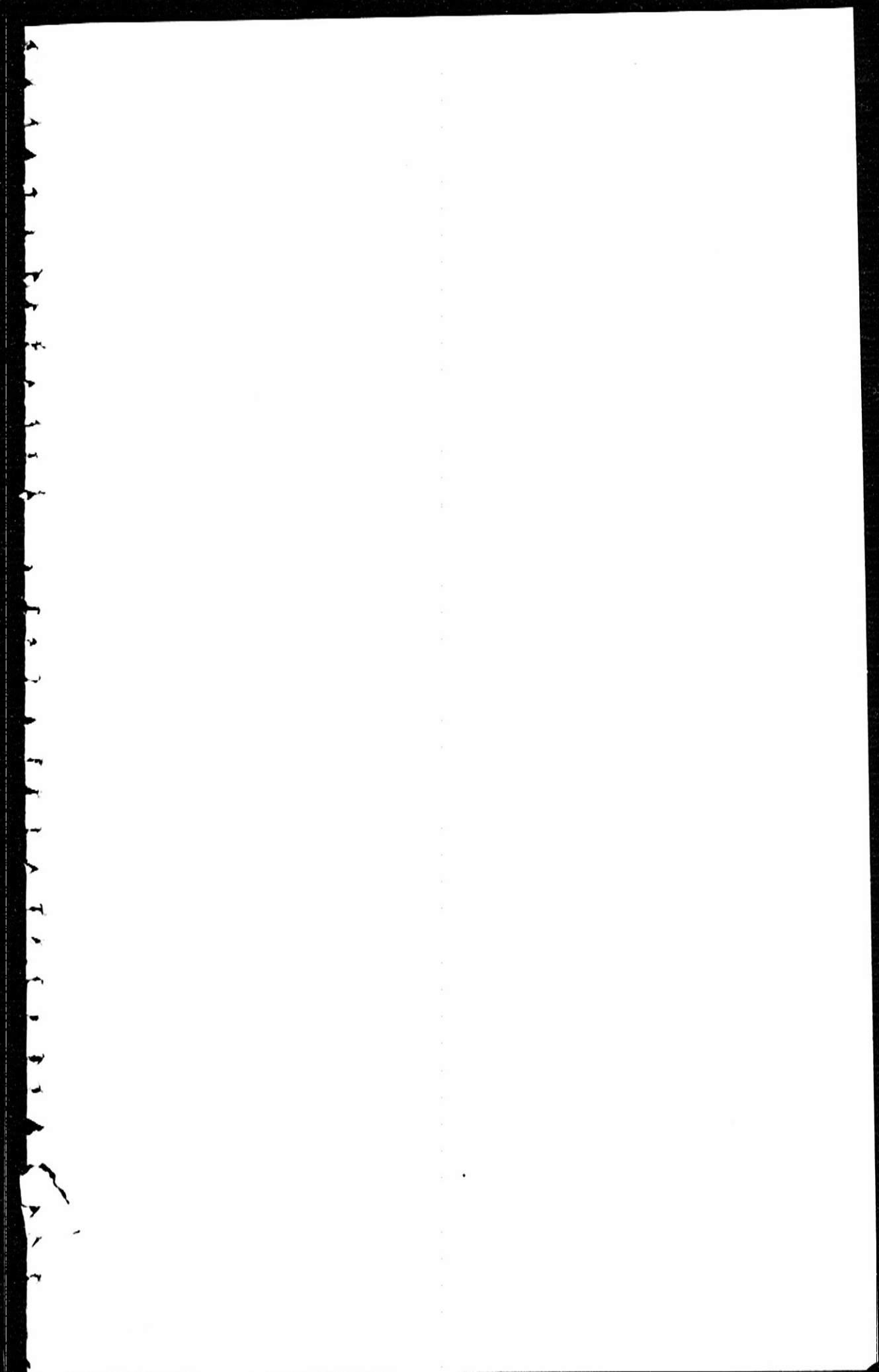
² Page 6, line 39, *infra*.

We will, therefore, by this announcement amend the appendix to our Statement of General Policy, 61-1, to include a price level of 20.96 cents per Mcf at 14.65 psia (21.5 cents per Mcf at 15.025 psia) for initial sales from Southern Louisiana and Mississippi. This level represents our judgment as to a proper price at this time, based upon current conditions and a full and careful consideration of all of the factors set forth in our original statement. It is intended to operate for sales not previously considered by us in connection with permanent certification. Previously certificated sales from this area, at the same or other price levels, were the result of our judgment of the situations at the time those cases came before us. The present announcement, of course, is neither a repudiation of our previous decisions nor a prejudgment of the cases presently being reconsidered separately by us upon remand from the Supreme Court.

By the Commission. Chairman Kuykendall dissenting.

[SEAL]

JOSEPH H. GUTRIDE,
Secretary.



BRIEF FOR INTERVENOR-RESPONDENTS

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT.

No. 15461.

PUBLIC SERVICE COMMISSION OF THE STATE
OF NEW YORK,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent,

TEXAS GAS EXPLORATION COMPANY, *et al.*,

Intervenor-Respondents.

**ON PETITION TO REVIEW AN ORDER OF THE
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Statement of Question Presented.

In the opinion of producer-intervenors the question is: did the Commission abuse its discretion in refusing to impose a price condition in the certificates of public convenience and necessity issued to the producer-applicants?

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Counter-statement of the Case.

(a) The Applications for Certificates.

The twenty-one producers¹ joining in this brief filed separate applications with the Commission, each seeking a certificate of public convenience and necessity under §7(c) of the Natural Gas Act [56 Stat. 83; 15 U. S. C. §717f (c)] to sell to Hope Natural Gas Company natural gas produced in southern and offshore Louisiana. These sales, together with a small amount of gas which Hope will produce for itself, would enable the delivery to Hope's customers of approximately 100,000,000 cubic feet of gas per day.

Hope, Texas Gas, and Texas Eastern filed separate applications for certificates, each seeking authority to undertake its respective role in getting the gas from the producing fields to Hope's customers in the northeast.

The Commission consolidated all of the applications for hearing. The hearing began on June 10, 1959 and concluded on June 25, 1959. The New York Public Service Commission, petitioner here, participated in the hearing as an intervenor. None of Hope's customers intervened in opposition.

¹ The producers, together with Hope Natural Gas Company, Texas Gas Transmission Corporation and Texas Eastern Transmission Corporation, were permitted to intervene in this review proceeding subject to the filing of a single consolidated brief. By order issued herein on March 4, 1960, the producers were allowed to file a joint brief in support of the Commission's order, and Hope, Texas Gas and Texas Eastern were allowed to file a joint brief in support of the order. Mississippi River Fuel Corporation was not specifically named in the Court's order of March 4, 1960, but that company was permitted to intervene on the side of respondent by order of January 22, 1960, and joins in this producer-intervenor brief. This brief, therefore, is in behalf of all of the producers who were applicants for certificates before the Commission, namely: Texas Gas Exploration Corporation, J. Ray McDermott & Co., Inc., Callery Properties, Inc., Ocean Drilling & Exploration Company, Humble Oil & Refining Company, Amerada Petroleum Corporation, Kerr-McGee Oil Industries, Inc., Caroline Hunt Sands and Loyd B. Sands, Socony Mobil Oil Company, Inc. (successor by merger to Magnolia Petroleum Company), Beck Oil Company, *et al.*, Phillips Petroleum Company, Union Oil Company of California, Tidewater Oil Company, Continental Oil Company, Shell Oil Company, Pan American Petroleum Corporation, The California Company, Kilroy Properties, Inc., *et al.*, Bel Oil Corporation, Richardson & Bass (Louisiana Account) Operator, and Mississippi River Fuel Corporation. These parties will be referred to sometimes as "producer-respondents" or "producer-applicants".

(b) The Evidence.

1. The contract negotiations and the contracts.

Each of the producer-applicants presented its contract of sale, together with evidence that there was no corporate affiliation between it and Hope, the purchaser, and that the negotiations leading to the execution of the contract were at arm's length. Each established that it was able and willing to perform its contract and to conform to the provisions of the Gas Act and the regulations of the Commission.

Most of the contracts provide for initial prices of 21.5¢ per Mcf plus 2.05¢ per Mcf tax reimbursement. Four contracts are at initial prices of 21¢ per Mcf plus 2.05¢ tax reimbursement. Most of the contracts are for terms of twenty years (a few for twenty-one), and each calls for periodic increases of 1¢ per Mcf each four years. Some of the contracts (covering about 26% of the proved reserve) authorize price redeterminations after twelve years; the remainder authorize redeterminations after eight years. There are no favored nation clauses in any of the contracts. In total the contracts commit to Hope gas produced from proved reserves in the order of 600 billion cubic feet from which about 100,000,000 cubic feet per day will be delivered to Hope's customers.

The initial base prices of 21¢ and 21.5¢ per Mcf represent the lowest prices at which Hope could purchase gas in southern and offshore Louisiana (R. 1169). Mr. J. J. Schmidt, Hope's Vice President in charge of gas procurement who negotiated the contracts during the period June to December, 1958, testified that these prices are less than initial prices in many other recently-executed contracts in the areas and less than the prices then currently (1958) being offered for gas in those areas (R. 1169).

When Mr. Schmidt consummated the instant contracts for Hope, he had been in the territory for about two and a half years and knew that prices then being paid for new gas ranged from 17¢ to 25¢ per Mcf. Some of the sellers here were already selling gas at 21.5¢ and some at 22¢ per

Mcf. Mr. Schmidt offered J. Ray McDermott & Co., Inc. (operator of the largest block of gas eventually contracted for) 21.5¢ per Mcf. He testified that this price was not accepted by McDermott or the other producers until after many meetings and extended negotiations (R. 1232-1233).

There appears to be no dispute about the foregoing facts.

2. Need for the gas by Hope and its customers.

Hope and its customers have a critical need for this gas (R. 1171-1172). The Consolidated Natural Gas System, of which Hope is a member and the principal gas supplier through its own production and purchases from others, serves over 1,000,000 customers in Ohio, Pennsylvania and West Virginia. The System also supplies gas at wholesale to non-affiliated companies serving over 300 communities in New York, Pennsylvania and West Virginia (R. 1178). The System will require additional supplies of gas of approximately 37.3 billion cubic feet in 1960; 57.6 billion cubic feet in 1961; and 70.6 billion cubic feet in 1962 (Exh. No. 13, R. 3220).²

Petitioner appears to admit Hope's need of the gas.³

3. The proposed prices; their comparability with other prices in the area; and the absence of adverse impact on Hope and its customers.

Commission Staff Counsel participated in the hearing and presented one witness (Hodge) who sponsored an exhibit reflecting some prices paid for gas in southern Louisiana (Exh. 32, R. 3409-3417). This exhibit shows that as of May 1959 prices equal to and in excess of those involved here were being paid under permanently certifi-

² Further details and estimates of the System's gas requirements are shown at R. 1184-1186, 1189, 1546, 1571 and in Exh. 13, R. 3258-3261, 3269-3271.

³ Petitioner's petition for rehearing and reconsideration of Opinion No. 327 is reproduced as Exh. B to its Petition for Review herein. Petitioner there states (B-8): "Of course Hope 'needs' the gas—i. e., needs it to permit of its sale of larger quantities to satisfy the Consolidated System's legitimate desire to distribute more gas to more people."

cated sales for gas produced in the same area as the instant gas (Exh. 32, R. 3412). The exhibit is limited to the years 1957-1959 and covers six parishes in south Louisiana (R. 1653, Exh. 32, R. 3411-3412). The witness testified that because the prices in this case do not exceed "the highest certificated base price [i.e., excluding tax] on file for South Louisiana . . . [i.e.] 22 cents per Mcf", he did not see fit to prepare a detailed analysis for all of south Louisiana (R. 1643-1644).⁴

In April 1958 the Commission permanently certificated sales to Southern Natural Gas Co. (19 F. P. C. 558) of south Louisiana gas at initial prices of 21.5¢ per Mcf, plus 2.05¢ per Mcf tax reimbursement, under contracts which call for fixed increases of 2¢ per Mcf each four years, whereas the contracts involved here call for similar increases of only 1¢ per Mcf (R. 1170-1171, Exh. 32, R. 3412).⁵ Some of the wells from which the gas is being delivered to Southern Natural are in the same field (Bayou Pigeon) as some of the gas involved here, and at the date of hearing such wells were actually draining gas from under leases involved here (R. 498-499). The prices in the sales to Southern Natural are final in that they are not under challenge on appeal (Exh. 32, R. 3412, 1664-1667).

Witness Hodge testified that the prices here of 21.5¢ per Mcf plus tax reimbursement were "in line" (R. 1667) with prices paid under permanently certificated sales in the same area (R. 1664-1667). He also stated that (R. 1645)

⁴ In addition, Hope's witness Schmidt cited three more instances where certificates had been issued authorizing sales in southern and offshore Louisiana at initial prices (excluding tax reimbursement) as high or higher than those involved here, namely (R. 1170):

Docket No. G-13082, <i>et al.</i> [19 F. P. C. 558]	
Southern Natural Gas Company	21.5¢
Docket No. G-13143, <i>et al.</i> [Opinion No. 315, 20 F. P. C. 264]	
Transcontinental Gas Pipe Line Corporation	22.0¢
Docket No. G-15394, <i>et al.</i> [Opinion No. 321, 21 F. P. C. 704]	
Trunkline Gas Company	22.0¢

⁵ As to some of the producer-applicants here, Southern Natural had offered to buy their gas at the 21.5¢ initial price, prior to the offer by Hope (R. 499, 500).

"Including the sales to Trunkline Gas Company,⁶ . . . there are 17 recent sales in the area shown in the exhibit that have prices equal to or above the proposed price of 21½ cents per Mcf." The staff witness testified that he was not making any recommendation with respect to any price condition in these proceedings (R. 1648, 1650). Furthermore, the instant prices are in line with or below prices in existing intrastate sales in the area (see, for example, R. 409).

As to the lack of impact of these sales on Hope and its customers, these are Hope's first purchases of gas in Louisiana (R. 1663-1664), and Hope will not construct nor require new facilities in connection with this project (R. 1551, 1566). All of the gas will be delivered in Hope's behalf at existing delivery points to its existing customers *under Hope's currently filed rate schedules applicable to those customers* (R. 1548-1549). And, the total cost to Hope of the instant gas at the points where the gas will be delivered to its customers is about 3¢ to 5¢ per Mcf less than Hope's currently filed rate schedule to those customers. The total cost to Hope at the delivery points where the instant gas will be delivered to its customers is 44.825¢⁷ per Mcf; whereas, Hope's currently effective rates to those same customers are (R. 1549):

The East Ohio Gas Co.....	50.63¢ per Mcf ⁸
The Peoples Natural Gas Co.....	48.19¢ " "
New York State Natural Gas Corp.	48.19¢ " "
The River Gas Co.....	48.19¢ " "

⁶ In *Trunkline* the Commission certificated sales in southern and offshore Louisiana at initial prices of 22¢ per Mcf, excluding tax reimbursement (21 F. P. C. 704). The New York Commission, petitioner here, sought review in this Court in *Trunkline* (*Public Service Comm. v. F. P. C.*, No. 15365, CADC). By order in No. 15365 dated April 28, 1960 this Court dismissed the petition for review on jurisdictional grounds.

⁷ In view of a condition which the Commission attached to the certificate issued to Texas Gas (R. 4739) the total cost of the instant gas to Hope is 44.825¢ per Mcf instead of 45.325¢ per Mcf as reflected in Item EE by reference, R. 4332-4335.

⁸ This includes a rate increase filed by Hope shortly before the hearing. But even before the increase Hope's rate to East Ohio was 49.25¢ per Mcf (R. 1549), or almost 4¢ per Mcf more than the cost of the instant gas at the same delivery point.

With respect to impact on Hope's customers, Mr. Francis Wright, an officer of East Ohio Gas Co. (Hope's largest customer), testified on cross-examination as follows (R. 1588-1589):

"Q. Mr. Wright, do you have any knowledge as to whether or not Hope Natural proposes to or will be required to increase its rate to your company [East Ohio] as a result of its proposal in this proceeding? A. No, I don't, but offhand I can't see how when Hope is charging East Ohio 50.63 cents and in the future considering the gas in this case, with an additional 100 million a day or 36 billion cubic feet annually rolled into Hope's sales at something like a cost of 45 cents, that seems to me almost axiomatic that the only result could be a lower rate from Hope to East Ohio.

"Q. Then in your opinion the answer to the question would be that you cannot foresee how they [Hope] could increase their rate to you as a result of their acquiring the gas involved in this proceeding, is that correct? A. Yes."

Mr. Lloyd A. Scott, Manager of Rates for Hope, testified on cross-examination as follows (R. 1637):

"Q. With respect to all applications involved in this proceeding, that is, the pipeline applications and the independent producer applications, will the proposed transportation service and the proposed producer sales require an increase in the rates by Hope Natural to its affiliates? A. No, it will not.

"Q. And do I correctly understand you to testify that in your considered judgment the granting of all of the applications in this consolidated proceeding will not have an adverse financial impact upon the customers of Hope Natural Gas Company? A. That is correct."

With respect to the cost to Hope of other *field purchases* by it, Mr. Scott of Hope testified (R. 1560):

"During the year 1958 the average cost of gas purchased by Hope in the Appalachian area was

24.05⁹ cents per Mcf, at various pressure bases at which we purchase gas in West Virginia and Virginia."

The foregoing testimony is undisputed, and petitioner conceded in its petition for rehearing that there were many previously issued permanent certificates "in the 23¢ price range" in southern Louisiana.¹⁰

Statute Involved.

Pertinent provisions of the Natural Gas Act [§7(c), §7(e) and §19(b)] are set out in the appendix hereto.

Summary of Argument.

A. On the basis of an exhaustive record and after the matter was fully argued to it orally and in briefs the Commission—with scrupulous regard to *Catco*¹¹—sifted and evaluated the evidence and found "the producer applicants have sustained their burden of showing that the prices are required by the public convenience and necessity, and that there is no adequate basis or reason for denying or conditioning the producer certificates herein sought" (R. 4735); and "To deny these supplies to Hope would be a disservice to all of the consumers dependent upon it for their gas" (R. 4736).

Subsidiary to its ultimate finding that the producers' applications at the proposed prices "are required by the public convenience and necessity" (R. 4738) the Commission specifically found:

1. Nothing to signal the existence of a situation which would indicate that the issuance of permanent certificates is not in the public interest (R. 4736);

2. The proposed prices are not out of line with prices currently being charged in Louisiana (R. 4736);

⁹ This, of course, is ½¢ per Mcf higher than the highest price, including tax reimbursement, which Hope will pay the producers for the gas involved here.

¹⁰ Petition for Review, B-4.

¹¹ *Atlantic Refining Company v. Public Service Commission of the State of New York*, 360 U. S. 378 (1959).

the prices will set no new plateaus in Louisiana, either offshore or in the onshore fields (R. 4733); and the prices are the same or lower than numerous other certificated sales in the area (R. 4735);

3. These are Hope's first purchases in this area and no favored nation clauses will be triggered, either to Hope or to other purchasers (R. 4733); and there will be no triggering at all (R. 4736);

4. The proposed prices will have no adverse effect on any other purchasers in southern Louisiana (R. 4733);

5. There will be no increase in Hope's existing rates to its customers as a result of certification at these prices (R. 4736);

6. Hope and its customers have a real need for this gas (R. 4733-4734);

7. The contracts do not contain favored nation clauses; they have fixed purchase prices for at least eight years; and they call for price increases of only 1¢ per Mcf each four years whereas other contracts heretofore approved in the same area call for increases of 2¢ per Mcf each four years (R. 4733).

All of these findings are supported by substantial evidence and thus fully sustain the ultimate findings that unconditioned certificates are in the public convenience and necessity. In these circumstances the Commission could not have reasonably acted otherwise, and hence there was no abuse of discretion in not imposing price conditions.

It is difficult to understand how it can realistically be urged that these sales at the proposed prices are not in the public convenience and necessity where, as here: (1) the evidence establishes (R. 1171-1172, 3230), the Commission found (R. 4736), and petitioner concedes (Pet. for Rev., B-9), that to deny certificates would be a disservice to all the consumers dependent on Hope for gas; (2) Hope's current rates will not, and indeed cannot, be increased as a result of the attachment of these substantial supplies (R. 1588-1589, 1673); and (3) the producers' prices will not have any disturbing or increasing effect on existing

or future prices in the field (R. 506, 508, 509, 1170, 1664-1667, 3412, 4733-4736). Thus, unless the Commission's considered and factually supported judgment in matters pertaining to the attachment of price conditions is to be held for naught, and price conditions are to be imposed at random and for the mere sake of their imposition, it is respectfully submitted that the Commission's order may not properly be set aside.

B. The *Catco* decision did not condemn the prices involved in that case, nor did it fix a precise level of initial prices above which the Commission could not issue unconditional certificates. *Catco* admonished the Commission to scrutinize initial prices together with all factors affecting the public convenience and necessity, and it set forth certain guides to govern the Commission's disposition of certificate applications. The Commission gave full credence here to that decision, adhered to its guides, and found that this record supports the issuance of unconditioned certificates.

The Commission's order clearly shows that close attention was given to *Catco* (R. 4734-4735). That the Commission was alert to its responsibility under *Catco* is indicated by its contrasting action in price conditioning producers' certificates in its order in another certificate proceeding issued on *the same day* as its order here. Simultaneously with the issuance of the instant order the Commission issued its order in *Transwestern Pipeline Co., et al.*, 22 F.P.C. 391. On the basis of *Catco*, price conditions were there attached to a number of certificates issued to producers. Petitioner refers to several orders issued on August 10, 1959 in which the Commission issued certificates *without* price conditions (Br. p. 23, fn. 23), but petitioner fails to mention the simultaneously issued *Transwestern* order in which price conditions *were* imposed. This simultaneous but different action on different records—each examined in the light of *Catco*—demonstrates the close attention which the Commission gave to the records in the cases then under consideration by it. Such action fully dissipates the cloud of inattention to *Catco* with which peti-

tioner attempts to enshroud the Commission's action in this case.

C. Developments in *Transco-Seaboard*¹² have no bearing on this case. In that proceeding the Commission's order was issued *before Catco*. Here the Commission's order was issued *after Catco* and after the Commission had analyzed the record in the light of that decision. In *Transco-Seaboard* the Supreme Court's order merely recognized that initially it was for the Commission, not the court, to examine the facts and pass on the propriety of issuing unconditional certificates in the light of *Catco*.

ARGUMENT.

I.

The commission did not abuse its discretion in issuing certificates to the producers without price conditions in view of its adequate findings supported by substantial evidence that the producers' sales at the proposed prices were in the public convenience and necessity.¹³

The initial circumstance favoring the Commission's order is its correctness; the second is that the Commission made all necessary findings which, in turn, are supported by substantial evidence on the record in its entirety. The Commission's action was reasonable. It did not abuse its discretion. On the basis of this record, we submit that the imposition of price conditions would have been an abuse of discretion, would not have comported with the requirement

¹² *United Gas Imp. Co. v. F. P. C.*, 3 Cir., 269 F. 2d 865 (1959) vacated in *Public Service Comm. v. F. P. C.*, 361 U.S. 195 (1959).

¹³ Petitioner does not urge denial of certificates. In its Petition for rehearing (B-2 of Petition for Review herein) petitioner stated: "... We raise no objection to the certification of the sales *per se*. We object only to the Commission's doing so without limiting or conditioning the initial price at a level *per se* no higher than that demonstrated to be required by the public convenience and necessity."

of §7(e) that the condition be "reasonable", and would have exceeded the conditioning power as contemplated in *Catco*.

Section 7(e) leaves to the judgment of the Commission whether the requisite criteria have been established for the issuance of certificates. That section also invests the Commission with power to attach "such *reasonable* terms and conditions as the public convenience and necessity may require". While the Commission has discretionary power on the basis of proper evidence to impose price conditions, the exercise or the failure to exercise the power is, of course, subject to judicial review on the issue of abuse.

The power to grant certificates and the power to attach conditions are interrelated to the extent that when, as here, the Commission finds on the basis of substantial evidence that the sales, *at the proposed prices*, are required by the public convenience and necessity, then, of course, the imposition of price conditions is precluded. We submit that the Commission's finding that certificates without price conditions should issue is fully supported by substantial evidence, and thus there was no abuse of discretion in not attaching conditions. To have attached price conditions would have been without evidentiary support.

In *United States v. Pierce Auto Freight Lines*, 327 U. S. 515 (1945), the Court, in reviewing certification of motor carrier service by the Commerce Commission, said (327 U. S. at 535):

"* * * [The function of the reviewing court] is limited to ascertaining whether there is warrant in the law and the facts for what the Commission has done. Unless in some specific respect there has been prejudicial departure from requirements of the law or abuse of the Commission's discretion, the reviewing court is without authority to intervene. * * *"
Cf. *U. S. v. Detroit & Cleveland Nav. Co.*, 326 U. S. 236, 241 (1945).

In *Oklahoma Natural Gas Co. v. F. P. C.*, 103 U. S. App. D. C. 256, 257 F. 2d 634 (1958), cert. granted 358 U. S.

877, cert. dismissed under Rule 60, 358 U. S. 948, this Court, in reviewing an order of the Commission issuing certificates but refusing to impose price conditions, said (257 F. 2d at 638):

"An examination of the evidence is necessary to determine whether the Commission abused its discretion in refusing to impose a price condition on the certificates issued to Natural and Producers."

In speaking of §7(e), the Court observed (257 F. 2d at 640):

"It is obvious that the plain congressional meaning is to vest the Commission with the discretion to attach terms, including rate conditions. It is fitting that there should be this discretion and, in the absence of an abuse of that discretion, courts should not interfere. We find no such abuse here."

In *National Coal Ass'n. v. F. P. C.*, 89 U. S. App. D. C. 135, 191 F. 2d 462 (1951), in passing on an order by the Commission issuing a certificate under §7(e), this Court said (191 F. 2d at 467):

"These findings [that the applicant had met the criteria of §7(e)] satisfy the statutory requirements and 'if supported by substantial evidence, shall be conclusive'." [citing §19(b) of the Gas Act—15 U. S. C. A. §717r (b)].¹⁴

The evidence in this case (see pp. 2-7, *supra*) establishes beyond question that the producer-applicants were entitled to certificates without price conditions. The New York Commission participated in the hearing and cross-examined the producers' witnesses, but presented no witnesses of its own. The Commission's staff participated in

¹⁴ See also: *Interstate Commerce Comm. v. Parker*, 326 U. S. 60, 65 (1945); *Minneapolis & St. Louis Ry. v. U. S.*, 4 L. ed 2d 223, (1959); *Florida Economic Advisory Council v. FPC*, 102 U. S. App. D. C. 152, 251 F. 2d 643 (1958), cert. den. 356 U. S. 959 (1958); *National Coal Ass'n v. FPC*, 101 U. S. App. D. C. 95, 247 F. 2d 86 (1957); *Michigan Consol. Gas Co. v. FPC*, 3 Cir., 246 F. 2d 904 (1957), cert. den. 355 U. S. 894 (1957); *Dept. of Conservation of Louisiana v. FPC*, 5 Cir., 148 F. 2d 746 (1945).

the hearing and presented one witness (Hodge) who sponsored the exhibit showing certain prices in Louisiana. This witness testified that the instant prices were "in line" with other certificated prices in the area (R. 1665-1667). His exhibit confirms the accuracy of that view. In commenting on this exhibit the Commission stated (R. 4733, fn. 3):

"Our staff's Exhibit No. 32 in this case shows that as of January 1, 1959 there were 61 interstate sales accepted from southern Louisiana at prices ranging from 22.0¢ to 22.9¢ per Mcf, including tax, and 41 at prices between 23.0¢ and 23.9¢, including tax. In the specific parishes in which the sales proposed herein will be made, we have certificated 16 sales at base prices equal to or higher than Hope will pay. • • •"¹⁵

Taking into account the evidence in its entirety and the fact that there is nothing in the record which fairly detracts therefrom or from the Commission's findings of fact, we submit that the substantiality of the evidence in support of the findings made by the Commission is beyond doubt. The following is, we believe, a fair summary of the facts as established in the record:

1. There is a real and urgent need for this gas by Hope's many customers and the present and prospective consumers in turn served by them (R. 1171-1172, 1184-1186, 1189, 1546, 1571; Exh. 13, R. 3220).

2. The prices proposed by the producers:

- (a) Are not out of line with going prices (in both interstate and intrastate (R. 409) sales) in southern or offshore Louisiana, nor will they trigger general price

¹⁵ In Opinion No. 325 (*South Georgia Natural Gas Co., et al.*, Docket No. G-9892 *et al.*) issued August 7, 1959, the Commission in certificating sales in southern Louisiana at a base price of 21.5¢ per Mcf, exclusive of tax, took note of the existence in southern Louisiana of the sale of gas reserves "in an intrastate market for an initial price of 24.8 cents per Mcf, including tax reimbursement" (p. 12, Opn. 325). Since the maximum tax in Louisiana on severance and gathering of gas is 2.3¢ per Mcf (25 LSA-R. S. 47:633), the base price in this non-jurisdictional sale was at least 22.5¢ per Mcf.

risers in the area. The instant prices are only equal to or lower than many other permanently certificated prices to other interstate pipelines in the area (R. 506, 508, 509, 1170, 1664-1667, Exh. 32, R. 3412), and thus will not establish a new price plateau. Also, the instant prices are less than the price currently (and in recent years) being offered for gas in the area (R. 499, 500, 1160). This situation exists not because of the instant contracts, but wholly apart from them.

(b) Will not trigger any price increase in any other contract of Hope because this is Hope's first purchase in Louisiana (R. 1663-1664).

(c) Will not have an increasing or triggering effect on any other purchasers of gas because there are already an abundant number of certificated prices in the area at or above the level of the instant prices (see references at (a) above, also R. 355, 442).

3. These substantial additional supplies will be laid down at existing delivery points in the Appalachian area to Hope's customers at a cost to Hope of between 3¢ and 5¢ less than its currently effective rates to those same customers (R. 1548-1549, 1588).

4. No additional facilities will be required by Hope in the consummation of this project (R. 1566).

5. This entire project, if certificated as proposed, will not cause an increase in Hope's rates and will not have an adverse financial impact on Hope's customers (R. 1637); and this project could not support an increase in Hope's rates even if one were sought (R. 1588).

6. Not a single customer of Hope has intervened in opposition to the producers' proposed prices.¹⁶

¹⁶ The gas involved here will be delivered initially to affiliates of Hope. The Consolidated System, which consists of Hope and its affiliates, supplied gas at wholesale (at the end of 1958) to non-affiliated gas companies serving 335 communities in New York, Pennsylvania and West Virginia (R. 1178). Since Hope will not have to construct any additional facilities and since at the delivery point to Hope's customers this gas will cost Hope less than its currently effective rate to those customers, it is understandable that none of the ultimate recipients of this gas saw fit to oppose the producers' prices.

7. Hope's prices to the producers will be definitely known for at least 8 years, and in some cases 12 years. No price redetermination can be had before then (R. 4733).

8. The producer contracts do not contain favored nation clauses (R. 4733).

9. The fixed escalation is 1¢ per Mcf each 4 years, rather than 2¢ each 4 years as in some other recently permanently certificated sales in the same area to another pipeline (R. 4733).

10. The acreage committed under the contracts by the producer-applicants (nearly 35,000 acres) greatly exceeds the acreage presently proven as productive (approximately 7,000 acres), thus indicating the possibility of much larger future supply (R. 1173-1174, 304-305, 319, 322-323), all of which will be available to Hope under these contracts, with their stable prices.

Despite the foregoing uncontroverted evidence, petitioner contends that the Commission's order is "not supported by substantial evidence in the record, and [is] contrary to law."¹⁷ But in so contending petitioner relegates to the background the basis of the order, quite obviously manifested therein, and the abundant evidence which supports it. The record clearly disproves petitioner's contention of the lack of substantial evidentiary support for the Commission's findings. It affirmatively establishes full support for the Commission's order. Unless, therefore, the order rests on an erroneous legal foundation, we submit it should not be overturned.

¹⁷ Petition for Review, p. 6. At p. 7, *ibid*, petitioner goes so far as to assert that the Commission's approval of these sales was "without any evidentiary support therefor whatever", and (Br. p. 27 that the record "is devoid of evidence . . . to support . . . unconditional certificates."

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¹⁷ Petition for Review, p. 6. At p. 7, *ibid*, petitioner goes so far as to assert that the Commission's approval of these sales was "without any evidentiary support therefor whatever", and (Br. p. 27 that the record "is devoid of evidence . . . to support . . . unconditional certificates."

II.

The CATCO decision was properly interpreted and given full credence by the Commission; the Commission found that producer-applicants had satisfied all requirements of CATCO and its findings are fully supported by the record; CATCO did not invalidate the CATCO prices nor does it fix a precise level or line to which all future prices must adhere.

The basic fallacy in petitioner's position is the assumptions implicit in it that in *Catco* the Court held invalid the 21.4¢ price involved there and further that thereafter the Commission could not certificate any initial price higher than some obscure average of prices which petitioner says existed prior to the Commission's order in *Catco* (June 24, 1957). From this fallacious premise petitioner urges that here the Commission gave no consideration to *Catco*, but rather "distorted and undermined" it;¹⁸ and also that *Catco* and *Transco-Seaboard* provide a "definitive resolution of the issue, one which mandates reversal of the present unconditional certification."¹⁹

We submit petitioner's position is without merit for these reasons:

A. The Commission gave full consideration to and properly interpreted *Catco*.

The opening sentence in *Catco* is the best evidence of what the Court was testing:

"This proceeding tests the jurisdiction, *as well as the discretion*, of the Federal Power Commission in the certifying of the sale of natural gas. . . ." (360 U. S. at 380). (Emphasis added throughout.)

¹⁸ Petition for Review, p. 7.

¹⁹ Br. for Pet., p. 10.

The Court's conclusion on the discretion question is:

"Our examination of the record here indicates that there was insufficient evidence to support a finding of public convenience and necessity prerequisite to the issuance of the permanent certificates". (360 U. S. at 392).

The judgment on the entire matter is "an affirmance of the judgment [of the Court of Appeals] with instructions that *the applications be remanded to the Commission for further proceedings*" (360 U. S. at 394).

Without doubt *Catco* makes clear that the Commission must give "a most careful scrutiny and responsible reaction to initial price proposals" (360 U. S. at 391). But *Catco* carefully does not make price the sole criterion, saying "for §7(e) requires the Commission to evaluate *all factors* bearing on the public interest" (360 U. S. at 391).

Catco did not strike down the prices there involved, nor did it preclude their ultimate certification. Its main concern was with the insufficiency of the evidence, in that record and in that case, to support unconditioned certificates, particularly where the Commission had twice found a lack of sufficient evidence to support the proposed prices and such findings were never vacated nor additional evidence adduced to overcome them (360 U. S. at 381).

The fact that *Catco* ordered "*the applications . . . remanded for further proceedings*" and not with instructions to *deny or condition* the certificates, demonstrates, along with a reading of the opinion in its entirety, that the Court did not hold the prices *per se* contrary to the public convenience and necessity.

That the Commission in the instant case gave full credence to *Catco* is amply shown by a reading of the order as a whole (see, especially, R. 4734). That the Commission was acutely aware of its duty with respect to the imposition of price conditions in appropriate instances is shown by its contemporaneous action in price conditioning the *Trans-*

western certificates on the same day it issued its order here (*supra*, p. 9).²⁰

B. The Commission found on the basis of substantial evidence that all of *Catco's* requirements for the issuance of unconditional certificates were satisfied.

Perhaps the most significant expression in *Catco* with respect to price conditions is this (360 U. S. at 391):

"Where the proposed price is not in keeping with the public interest because it is out of line or because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of 'favored nation' clauses or otherwise, the Commission *in the exercise of its discretion* might attach such conditions as it believes necessary."²¹

Without repeating the Commission's findings, which are fully supported by the record (see pp. 7-8, *supra*), we submit that the evidence clearly negates the existence of each one of the *Catco* factors and, further, affirmatively establishes that the producers' sales at the proposed prices will not disturb things either at the field delivery end—the source of this project—nor at the pipeline delivery end, its destination.

²⁰ Since its order here the Commission, on the basis of *Catco*, has imposed price conditions in producers' certificates in: *Phillips Petroleum Co. et al.*, 22 F. P. C. 694; *El Paso Natural Gas Co., et al.*, F. P. C. , Opinion No. 335 issued February 23, 1960; and *Gulf Oil Corp., et al.*, (Docket No. G-17973, issued May 9, 1960). And in *Western Natural Gas Co.* (Docket No. G-16099, *et al.*, Feb. 15, 1960) the Commission partially *denied* a producer's certificate application because there was no showing that it would not trigger increases in other contracts of the purchaser.

²¹ *Catco* does not in our view require a price condition in every case merely by virtue of the fact that any one or all of these status quo disturbing factors exist. The opinion does not in terms so require and any implication to that effect seems clearly negated by the admonition that the Commission must consider "all factors" (360 U. S. at 391), and it is only where "the application" (not the price alone), "signals the existence of a situation that probably would not be in the public interest", *ibid.*, that the certificate should be denied or conditioned. But be that as it may in some other case, the fact is that here there is neither a signaling nor a status quo disturbing factor (see pp. 7-8, *supra*), and the Commission so found on the basis of substantial evidence; hence there was no occasion for either denial or conditioning of the certificates.

C. *Catco* did not prescribe a precise price level above which the Commission must deny or condition all producers' certificates.

Petitioner seems to contend that *Catco* compels the Commission to revert to some average of prices prior to June 24, 1957. But the *Catco* decision does not lend itself to such a distorted reading, and the Commission properly rejected it (R. 4735). To adopt petitioner's approach would, in effect, transfer the certificating and conditioning powers from the Commission to the courts, because inherent in petitioner's position is the erroneous premise that in *Catco* the Supreme Court fixed a precise price level at some average of years ago at which the Commission thereafter was bound to hold all initial prices.

Catco cannot reasonably be viewed as reaching such a result which would so drastically alter the scheme of regulation set up in the Natural Gas Act and thus frustrate the orderly division of functions between courts and agencies. The function of granting certificates and of imposing conditions is an administrative one made so by the Act and clearly recognized by the courts.²² Surely the Court in *Catco* did not intend judicially to transfer that function from the Commission to the courts.

As a part of its approach that all prices should be rolled back, petitioner is unwilling to accept recently certificated prices. It not only wants a pre-*Catco* line but it is not even willing to accept the "line" of pre-*Catco* prices as properly drawn forward by the Commission in the light of well-known economic changes which have occurred between 1954 and 1959. Petitioner apparently wants the line eroded to a contrived and meaningless "average" (Br. pp. 27, 31).²³ *Catco* does not require the reversion to 1954

²² See, for example, *FPC v. Idaho Power Co.*, 344 U. S. 17 (1952); *Sunray Mid-Continent Oil Co. v. FPC*, 353 U. S. 944 (1957).

²³ At page 31 of its brief, petitioner says: "It [Commission] does not (and cannot) claim that 20¢ represented a just and reasonable price in 1954, or a typical initial price, . . . or a median price, or anything other than the very highest price. . . ." The short answer is that 20¢ per Mcf, exclusive of tax, was well-embedded as the initial price for gas in southern Louisiana long prior to the Commission's order in *CATCO* (see

prices or any pre-*Catco* line, and it does not advert to any kind of "average" price, let alone one of long ago. And certainly it does not require that the "line" or "plateau" be one established by prices which have been found to be "just and reasonable" under a §4(e) or §5(a) proceeding (360 U. S. at 391).

Petitioner is forced to its untenable position because, as the Commission points out (R. 4735 including footnotes 4 and 5), many sales in southern Louisiana at base prices of 20¢ per Mcf had been certificated by it long prior to *Catco*. In short, it seems petitioner simply will not face the record in this case nor confront the Commission's findings which are amply supported.²⁴

III.

The *Transco-Seaboard* remand has no adverse effect on the Commission's order in this case.

The *Transco-Seaboard* proceeding involved an order of the Commission issued prior to *Catco*. On review, and after the Supreme Court's opinion in *Catco*, the United States

the Commission's reference to its pre-*Catco* orders certificating sales at these prices, R. 4735, including footnotes 4 and 5). The Commission, as its major premise, fixed the line as that established by post-*Catco* certificated prices in the area (R. 4736). Under the clear meaning of *Catco*, the Commission was empowered to do this. The Commission's reference to pre-*Catco* prices, equated to date, was merely to show that even under petitioner's erroneous approach the instant prices are still well in line (R. 4736).

²⁴ Petitioner says (Br. p. 27) that rising prices have compelled "untold millions of dollars" in payments by the consuming public. This is one of a number of instances where petitioner goes beyond the record in its criticism of the Commission (see Brief of Petitioner, pp. 13-23), and disregards the positive evidence in this record that the instant prices will not cause an increase to Hope's customers (R. 1588-1589, 1637). The Commission observed that certification of the instant prices will not cause "any increase in the weighted average cost of Hope's gas" (R. 4736), referring, of course, to the cost of Hope's gas to its customers. Petitioner converts this to average cost of "pipeline purchased gas" (Br. p. 32) and then ignores the finding of the Commission that the producers' prices here will cause no increase in Hope's existing rates to its customers (R. 4733, 4736). This latter finding, which goes to the heart of the matter of consumer protection, is fully supported by the record (R. 1588-1589, 1637).

Court of Appeals for the Third Circuit (269 F. 2d 865) affirmed the Commission's order, one judge dissenting on the ground that he felt the Commission, not the Court, should "reconsider in the light of" *Catco* (269 F. 2d at 870). On petition for writ of certiorari the Court, in a *per curiam* order, vacated the judgment of the Court of Appeals and remanded to that Court "with directions to remand the case to the Federal Power Commission for reconsideration and redetermination in the light of [Catco]." (361 U. S. 195).

We submit that *Transco-Seaboard* has none of the far-reaching consequences which petitioner attributes to it. The Supreme Court rendered no decision on the merits but did no more than agree with the views of the dissenting opinion in the Court of Appeals. The Court did not, as in *Catco*, remand "the applications to the Commission for further proceedings" (360 U. S. at 394), but merely remanded "for reconsideration and redetermination" in the light of *Catco*. Surely, by its order for remand to the Commission "for reconsideration and redetermination in the light of" *Catco*, the Supreme Court did not invalidate the prices there involved nor preclude the Commission from reaching the same conclusion it originally reached if upon reconsideration in the light of *Catco* it remained of the view that unconditioned certificates should be issued.²⁵

²⁵ It seems settled that a remand for reconsideration does not preclude the lower tribunal from adhering to its original conclusion. See the related cases of *Barenblatt v. United States*, 354 U. S. 929 (1957); *Barenblatt v. United States*, 103 U. S. App. D. C. 320, 252 F. 2d 129 (1958); and *Barenblatt v. United States*, 360 U. S. 109 (1959); and also the related cases of *Joiner v. United States*, 357 U. S. 573 (1957); *United States v. Joiner*, 258 F. 2d 471 (1958); and *Joiner v. United States*, 358 U. S. 880 (1958).

IV.

The Commission was fully empowered to take official notice of the general inflationary trends in the cost of exploring for and producing natural gas, and to draw upon its knowledge that deep drilling in the almost inaccessible offshore and bayou areas is more expensive than drilling on dry land.

Petitioner challenges the Commission's observations in regard to the foregoing (Br. pp. 30-31), claiming that the Commission resorted to speculation and "unsupported, 'iffy' surmises" (Br. p. 31). In this connection, it is noteworthy that the Commission took notice of these factors only after it had found that the prices proposed here were "not out of line with prices currently being charged in Louisiana" (R. 4736, 4733) and after it disagreed with petitioner that it could consider only pre-Catco prices (R. 4735). The Commission did not deem itself bound to look only to pre-Catco prices, but did so merely to demonstrate that petitioner was wrong in claiming that 18¢ was the pre-Catco level of prices (R. 4735) and to show that the prices here were fully in line when properly equated to pre-Catco prices (R. 4736).

But at any rate the Commission was fully justified in taking official notice of the inflationary trends which took place between 1954 and 1959 and to refer to the publication of the U. S. Bureau of Labor Statistics as a guide to the extent thereof.²⁶ The Commission was also justified in taking into consideration that the instant gas is produced from deep horizons and in almost inaccessible areas. These factors, which we submit are not subject to reasonable dispute, were the subject of proper notice by the Commission. In referring to them merely for the purpose of giving further demonstration of the fact that these prices were not out of line, the Commission properly drew upon

²⁶ In its petition for rehearing petitioner felt the trending would be proper provided petitioner's base was used (B-6 of Petition for Review).

the vast storehouse of information within its specialized field. *United States v. Pierce Auto Freight Lines*, 327 U. S. 515, 529-530 (1946); *Market Street R. Co. v. Railroad Comm. of Cal.*, 324 U. S. 548, 561-562 (1945).

Additionally, §7(d) of the Administrative Procedure Act (Act, June 11, 1946, c. 324, §7, 60 Stat. 241; 5 U. S. C. A. §1006(d)) provides in part:

"Where any agency decision rests on official notice of a *material fact* not appearing in the evidence in the record, any party shall *on timely request* be afforded an opportunity to show the contrary."

Petitioner clearly had the opportunity, when it sought rehearing, to make a timely request to show, if it could, the contrary to any material fact which the Commission officially noticed in reaching its conclusion.²⁷ Not having requested that opportunity, petitioner is precluded from urging such factor against the order, especially when, as here, the Commission's action was proper; whatever facts were officially noticed did not go to the core of the Commission's determination nor bear on its conclusion, but were merely additionally demonstrative of the fallacy of petitioner's position; and petitioner was not prejudiced thereby. See *United States v. Pierce Auto Freight Lines*, 327 U. S. 515, *supra*.

Conclusion.

The Commission was fully justified in issuing unconditioned certificates to the producer-applicants. The record lends itself to no other reasonable view. The Commission's findings of the facts requisite to the issuance of unconditioned certificates are fully supported by substantial evidence and were made after giving the most painstaking consideration to *Catco*. There was no abuse of discretion

²⁷ In its petition for rehearing (see Petition for Review, Exh. B) petitioner did not deny the facts nor request an opportunity to show the contrary. It urged the Commission (*ibid.* B-10) "to reconsider its Opinion No. 327 and thereupon to pursue course No. 1" [i.e., condition the certificates rather than deny them].

in not imposing price conditions. To have done so in the light of this record would have been unreasonable.

For the foregoing reasons we respectfully submit that the order of the Commission should be affirmed.

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Appendix

Pertinent provisions of the Natural Gas Act of June 21, 1938, c. 556, 52 Stat. 821, as amended by Act Feb. 7, 1942, c. 49, 56 Stat. 83, 15 U. S. C. 717-717w:

SECTION 7(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: * * * [56 Stat. 83; 15 U. S. C. §717f (c)].

* * * * *

SECTION 7(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public conven-

ience and necessity may require. [56 Stat. 83; 15 U. S. C. §717f (e)].

• • • • •

SECTION 19(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas Company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. * * * Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. * * * [72 Stat. 947; 15 U. S. C. §717r (b)].

**BRIEF FOR INTERVENORS, HOPE NATURAL GAS COMPANY,
TEXAS GAS TRANSMISSION CORPORATION AND
TEXAS EASTERN TRANSMISSION CORPORATION**

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 15,461

FILED MAY 31 1960

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION, ET AL., *Respondents*

On Petition For Review Of Order Of The Federal Power Commission

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COUNTERSTATEMENT OF QUESTION PRESENTED

Whether the Federal Power Commission's refusal to impose a price condition in certificates of public convenience and necessity issued to producer-applicants was reversible error where, in evaluating the factors bearing upon the public interest as contemplated by Section 7(e) of the Natural Gas Act and *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378 (CATCO), the Commission, based upon substantial evidence, found, *inter alia*, that: (1) there was an urgent consumer need for the additional supplies of natural gas; (2) there would be no increase in the purchaser's existing rates; (3) the producer prices were not "out of line" and would not establish a new price plateau in the producing area involved; and (4) these prices would not "trigger" any price increases either to the instant purchaser or to other gas purchasers under favored nation clauses of other contracts.

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Act 8 of 1958, LRS 47:678	11
Act 2 of Extraordinary Session for 1958, LRS 47:633	11
Act 3 of Extraordinary Session for 1958, LRS 47:681.1	11
The Natural Gas Act, Act of June 21, 1938, c. 556, 52 Stat. 821-833, amended by Act of February 7, 1942, c. 49, 56 Stat. 83, 15 U.S.C. 717-717w	
Section 7(e) (15 U.S.C. 717f(e)) ...	1, 4, 7, 8, 9, 20, 27

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 15,461

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION, ET AL., *Respondents*

On Petition For Review Of Order Of The Federal Power Commission

**BRIEF FOR INTERVENORS, HOPE NATURAL GAS COMPANY,
TEXAS GAS TRANSMISSION CORPORATION AND
TEXAS EASTERN TRANSMISSION CORPORATION**

COUNTERSTATEMENT OF THE CASE

This case concerns the validity of an order of the Federal Power Commission issuing certificates of public convenience and necessity, under Section 7(e) of the Natural Gas Act, to some 21 producers of natural gas, authorizing them to sell approximately 100,000,000 cubic feet of gas per day¹ to Hope Natural Gas Company (Hope) from fields in southern Louisiana and adjacent offshore areas for transportation and resale in interstate commerce.

¹ This volume also includes a small amount of Hope's own production.

Under arrangements with Hope, Texas Gas Transmission Corporation (Texas Gas) will gather, transport and deliver this gas at a point near Lebanon, Ohio, to Texas Eastern Transmission Corporation (Texas Eastern) which, in turn, will further transport this gas and then redeliver it, for the account of Hope, at existing delivery points in Ohio, Pennsylvania and West Virginia, presently utilized by Texas Eastern for its delivery and sale of natural gas to Hope's affiliated customers.²

The facilities to be constructed by Texas Gas, for the proposed transportation service, were estimated to cost \$39,600,000. The facilities to be utilized by Texas Eastern represent an estimated capital investment of approximately \$8,000,000, or a total capital investment, by both companies, of almost \$48,000,000.

Four of Hope's contracts for the purchase of gas provide for initial prices at 21.0 cents per Mcf and the remainder set the initial price at 21.5 cents per Mcf; each contract also provides for an additional 2.05 cents per Mcf as tax reimbursement (R. 1827-1828). All of the contracts are

² These customers include all of Hope's operating affiliates except Lake Shore Pipe Line Co., as follows: The East Ohio Gas Company, New York State Natural Gas Corporation, The Peoples Natural Gas Company and The River Gas Company. These Companies constitute the Consolidated Natural Gas System, are subsidiaries of the Consolidated Natural Gas Company, a registered public utility holding company, and will, for convenience, sometimes be referred to herein as "Consolidated," "Consolidated Companies" or "Consolidated System."

The Consolidated System is an integrated natural gas system engaged in all phases of the natural gas business. Its facilities are integrated and its available gas supplies are centrally controlled and dispatched. In such integrated operation, Hope serves as the "hub" or "balance" company in satisfying the requirements of its sister companies.

The System at the end of 1958 distributed gas, at retail, to approximately 1,150,000 residential, commercial and industrial customers in 793 cities and communities in Ohio, Pennsylvania and West Virginia, and supplied gas at wholesale to nonaffiliated gas companies serving 335 communities in New York, Pennsylvania and West Virginia. The cities and communities supplied have an estimated population exceeding 8,000,000. Many major industrial centers located in the Appalachian area are served by the System (R. 1178).

for terms of twenty years or more, and each calls for periodic increases of 1 cent per Mcf every four years (R. 1169). The contracts do not contain favored-nation clauses³ and do not provide for price redetermination until after eight years in contracts covering about 70% of the gas and until after twelve years in the remaining contracts (R. 1169-1170). The total reserves, thus far developed and dedicated by these contracts, together with those available from Hope's own acreage, are estimated to aggregate approximately 620 billion cubic feet (R. 730-732; 3051).

The Commission consolidated the separate applications for certificates filed by each of the producers and by Hope, Texas Gas and Texas Eastern. At the consolidated hearings, Petitioner, as an intervenor, urged, without itself having presented any evidence, that the Supreme Court's recent decision in *CATCO*⁴ precluded the issuance of certificates at the initial prices proposed and required either the denial of the certificates or the imposition of a condition reducing the price. No customer of Hope or of any of its sister companies intervened in opposition to granting the producer certificates at the initial prices proposed.

By opinion and order issued on August 10, 1959, the Commission, in addition to issuing certificates to Hope, Texas Gas and Texas Eastern,⁵ issued certificates to the producer applicants authorizing them to sell the gas to Hope at the initial prices proposed (R. 4724-4739).⁶

³ "Favored-nation" clauses, which are found in most long-term gas purchase contracts, provide generally that, under specified circumstances, the seller is entitled to the highest price which may be paid by the buyer throughout the term of the contract.

⁴ *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378 (1959).

⁵ Petitioner does not question the propriety of the issuance of these certificates, *per se* (Pet. Br. fn., 1, p. 1).

⁶ 22 FPC 378 (1959).

SUMMARY OF ARGUMENT

I

A. Basically, the Supreme Court's opinion in *CATCO* provided certain criteria for the Commission's guidance with respect to the initial prices proposed in producer applications under Section 7(e) of the Natural Gas Act. Negating that in such proceedings the price must meet the statutory standards of justness and reasonableness, the Court ruled that the Act's purpose of consumer protection would be satisfied by holding the price line generally, and, hence, in exercising its discretion, the Commission should be alert to situations which "probably would not be in the public interest", i.e., where

"the proposed price . . . is out of line or because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of 'favored nation' clauses or otherwise". (360 U.S. at 391)

B. In contrast to *CATCO*, the record here fully demonstrates the absence of any of the signals evidencing a situation not in the public interest.

1. Unlike *CATCO*, there is ample evidence showing that the initial prices proposed are in line with those prevailing in the area, and, as Petitioner has recognized, Hope could not have purchased the gas at a lower price. Prices equal to and in excess of those prices were already being paid under permanently-certificated sales for gas there produced.

2. Again, unlike *CATCO*, the evidence shows, and Petitioner does not dispute the fact, that no "triggering" of any general price rises will result from the producers' initial prices here involved.

3. Also, unlike *CATCO*, the evidence is clear that the prices proposed will not result in an increase in Hope's

rates. In attacking this finding, Petitioner overlooks the fact that the price paid by Hope to its pipeline suppliers is a "raw" price to which must be added Hope's substantial costs for the further services provided in connection with the resale thereof, whereas the instant gas will be delivered directly to Hope's customers without any facilities, services or handling by Hope.

4. Similarly, unlike *CATCO*, there is detailed evidence here showing Consolidated's urgent need for additional gas to meet the growing needs of the heavily-populated Appalachian area.

II

Petitioner's argument that, although the initial prices here are "in line" with prices now prevailing in southern Louisiana, these prices are "out of line" under *CATCO* and *Transco-Seaboard*⁷ because the Supreme Court in these cases required a price "roll back" to the alleged pre-*CATCO* level, is predicated on a misreading of these decisions.

A. 1. In *CATCO*, the Commission's allowance of the 21.4-cent base price there involved was set aside only because of deficiencies in the record; since its allowance on a proper record was not precluded, *CATCO* plainly contains no mandate requiring a price "roll back." While the Court knew of the Commission's certification of 21.5-cent prices in southern Louisiana, *CATCO* clearly was confined to the particular offshore sales there involved. Petitioner's argument assumes, contrary to all judicial precedent, that the Court passed on the validity of prices not in issue before it and without the benefit of the record in the proceedings in which the prices had been allowed.

2. Nor is a price "roll back" necessary to give substance to the Court's decision. Rulings limited to providing guid-

⁷ *United Gas Improvement Co. v. FPC*, 361 U.S. 195 (1959).

ance to the administrative agency or reversing findings for lack of evidence are common. In contrast, to read *CATCO* as prescribing a specific 17-cent price for certificating producer sales involves invasion of the legislative powers of rate making beyond the authority even of Congress to vest in the Supreme Court.

3. Similarly, the absence of a price "roll back" does not nullify *CATCO*. The Commission, since *CATCO*, has scrupulously adhered to its teachings. Holding the line, as admonished by *CATCO*, the Commission has, in a number of cases, imposed price conditions. Petitioner's basic disagreement with the Commission is Petitioner's view that the "line" should be held at the alleged pre-*CATCO* level. But, just as following *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), the Commission realistically imposed regulation as of the date of the Supreme Court's decision, here, too, there can be no question as to the legal and practical soundness of the Commission's holding the line on producer prices as of the date of the Supreme Court's decision in *CATCO*.

B. Contrary to Petitioner's vigorous assertions, the Supreme Court's *per curiam* opinion in *Transco-Seaboard* does not contain substantive rulings on the merits of the case. There, the Court merely followed the common judicial practice, in situations where it had rendered an intervening decision bearing on the general problem, of remanding the case for reconsideration in light of that decision. That such is the case is exemplified, *inter alia*, by the *Barenblatt* decisions^s of both this Court and the Supreme Court.

Although the lower court's decision here was issued after *CATCO*, the Commission's order granting the certificates was issued prior to *CATCO*. Since primary

^s *Barenblatt v. United States*, 100 U.S. App. D.C. 13, 240 F.2d 875 (1957), remanded 354 U.S. 930 (1957); 102 U.S. App. D.C. 217, 252 F.2d 129 (1958); *aff'd*, 360 U.S. 109 (1959).

responsibility for the granting of certificate lies with the administrative agency, the Supreme Court directed remand of *Transco-Seaboard* to the Commission in order to obtain a determination by the Commission, in contradistinction to the Third Circuit, that the granting of certificates in *Transco-Seaboard* conformed to the guide-posts provided in *CATCO*.

ARGUMENT

In a nutshell, Petitioner's position seems to be that the Supreme Court, in its opinions in *CATCO* and *Transco-Seaboard*, required all producer prices in southern Louisiana to be "rolled back" to an alleged pre-*CATCO* level of 17 cents per Mcf. While this appears to be the principal contention presented by Petitioner, a material portion of its brief is devoted to a distorted version of the history of producer prices in southern Louisiana and actions by the Federal Power Commission relating thereto. This is quite obviously an attempt to create a "flavor" calculated to persuade this Court to interpret these decisions in a manner never intended, expressly or impliedly, by the Supreme Court.

Properly read, the Supreme Court in *CATCO*, in addition to upsetting the Commission's order for lack of adequate evidence, provided, within the confines of constitutional limitations on its powers, criteria for the guidance of the Commission in the exercise of its discretion under Section 7(e) of the Natural Gas Act, at least during this formative period while the ground rules of producer regulation are being evolved. And *Transco-Seaboard* added nothing thereto. Accordingly, the Commission in the instant case properly interpreted *CATCO* as not requiring a "roll back" of prices and, based upon the record here, did not abuse its discretion in issuing the certificates which are before this Court for review.

I

THE SUPREME COURT'S DECISION IN CATCO PERMITS THE ISSUANCE OF CERTIFICATES AT THE PRICES PROPOSED ON THE RECORD IN THIS CASE**A. The Meaning of CATCO**

The Supreme Court's decision in *CATCO* established, for the first time, certain guideposts to be followed by the Commission with regard to initial prices in certificate applications by producers under Section 7(e) of the Natural Gas Act. The Court's opinion may be fairly summarized as follows:

1. While the purpose of the Natural Gas Act is to underwrite just and reasonable rates to the consumers of natural gas (360 U.S. at 388-390), "the Act does not require a determination of just and reasonable rates in a §7 proceeding as it does in one under either §4 or §5. Nor do we hold that a 'just and reasonable' rate hearing is a prerequisite to the issuance of producer certificates." (360 U.S. at 390-391)

2. Rates are not "the only factor bearing on the public convenience and necessity, for §7(e) requires the Commission to evaluate all factors bearing on the public interest." (360 U.S. at 391)

3. However, "a most careful scrutiny and responsible reaction to initial price proposals of producers under §7" is required. (360 U.S. at 391) The fact that prices have leaped from one plateau to the higher levels of another makes price a consideration of prime importance, particularly "during this formative period when the ground rules of producer regulation are being evolved." (360 U.S. at 391)

4. "Where the application on its face or on presentation of evidence signals the existence of a situation that probably would not be in the public interest," i.e., "because [the proposed price] is out of line or because its approval might result in a triggering of general price rises or an increase in an applicant's existing rates by reason of 'favored nation' clauses or otherwise," the Commission may, in its discretion, deny

the certificate or impose rate conditions if appropriate. (360 U.S. at 391)

5. In these ways, "Section 7 procedures . . . act to hold the line awaiting adjudication of a just and reasonable rate. Thus the purpose of the Congress 'to create a comprehensive and effective regulatory scheme,' . . ., is given full recognition." (360 U.S. at 392)

From the above, it is clear that the Supreme Court did not intend to infringe upon the discretion delegated by Congress to the Commission.⁹ However, the Court did admonish the Commission carefully to scrutinize proposed initial prices with a view to holding the line against price rises and, to that end, to be alert to situations which "probably would not be in the public interest." Such situations, the Court further indicated, would be signaled where:

" . . . [T]he proposed price . . . is out of line or because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of 'favored nation' clauses or otherwise. . . ." (360 U.S. at 391)

In *CATCO*, the Supreme Court found that, in each of these respects, the record there signaled the existence of a situation not in the public interest. In this connection, the Court alluded to the following facts with particular and significant emphasis:

⁹ It is well established that the Commission has broad discretion in issuing certificates under Section 7(e) coupled with primary responsibility for evaluating the complex factors bearing on the public interest. See, e.g., *United States v. Detroit & Cleveland Nav. Co.*, 326 U.S. 236, 241 (1945); *United States v. Pierce Auto Freight Lines*, 327 U.S. 515, 535-536 (1946); *Florida Economic Advisory Council v. FPC*, 102 U.S. App. D.C. 152, 251 F.2d 643 (1958), *cert. denied*, 356 U.S. 959 (1959); *Oklahoma Natural Gas Co. v. FPC*, 103 U.S. App. D.C. 256, 257 F.2d 634 (1958), *cert. granted*, 358 U.S. 577 (1958), dismissed under Rule 60, 358 U.S. 948 (1959).

1. The initial price would set a pattern in the area where enormous reserves would appear to be present (360 U.S. at 390), and the price proposed would become the floor for future contracts in the area. (360 U.S. at 390)

2. The evidence that the price would not "trigger" increases in the leases with "favored nation" clauses was not convincing. (360 U.S. at 393)

3. The claim that the price would not lead to an increase in rates by the purchaser (Tennessee Gas Transmission Company) was not only unsupported, but had already been proven unfounded. (360 U.S. at 393)

4. There was no support whatever in the record for the conclusory finding on which the order of the Federal Power Commission was based that "the public served through the Tennessee Gas System is greatly in need of increased supplies of natural gas." (360 U.S. at 393)

B. The Commission Followed the Teachings of CATCO

It is readily apparent that the Commission not only understood the Supreme Court's decision in *CATCO* but also applied the precepts there laid down to the record in the instant case, with a full sense of responsiveness. In rejecting Petitioner's claim that *CATCO* barred the issuance of producer certificates here, the Commission first explained its reading of that decision (R. 4734):

"As we understand the *CATCO* decision, the Supreme Court held, in essence, that the producer's proposed initial price must be supported by substantial evidence establishing that the price is required by the public convenience and necessity and is in the public interest; that although the Commission should consider all the factors and has broad discretion in determining whether an initial price is so supported, price is an element of prime importance and the Commission should scrutinize the price closely with a view to protecting the consumer and holding the line against price rises. The Court further held that the Commission can

attach such price conditions as it believes necessary when the proposed price is out of line, when it might result in a triggering of general price rises by reason of favored-nation clauses, or when its approval might result in a general increase in applicant's existing rates."

It then went on to find that, unlike *CATCO*, the evidence in this case was *not* such as to signal the existence of a situation *not* in the public interest.

1. The Producers' Initial Prices Are "In Line" with Other Prices in the Area

The record here, unlike that in *CATCO*, amply shows that the prices here involved are in line with the prices prevailing in the area when the contracts were entered into.¹⁰ Indeed, Petitioner has recognized that the initial base prices of 21.0 cents and 21.5 cents per Mcf¹¹ contained in these contracts represent the lowest price at which Hope

¹⁰ Petitioner's argument to the contrary is predicated on the thesis that the Supreme Court in *CATCO* and *Transco-Seaboard* required the Commission to roll back producers' initial prices to the level allegedly prevailing prior to the Commission's order in *CATCO*, with the consequent result that it was improper for the Commission to take into account prices thereafter allowed by it in determining whether the producer's proposed price is in line. In Point II, *infra*, pp. 19-28, we show that such a reading of these decisions is wholly without foundation and contrary to settled principles of judicial administration and power.

¹¹ Petitioner, throughout its brief, amalgamates the base price involved with the provision for tax reimbursement in order apparently to inflate the price being paid. The tax imposed by the State of Louisiana upon the production, gathering or severance of gas has, however, had a variegated history. A severance tax of .3 cents was imposed in 1936, Act 119 of 1936, LRS 47:633; two separate one-cent gathering taxes were imposed in 1948 and 1958 by Act 11 of 1948, LRS 47:671 and Act 8 of 1958, LRS 47:678, respectively; finally, under Acts 2 and 3 of the Extraordinary Session for 1958, LRS 47:633 and LRS 47:681.1, these latter two gathering tax levies were suspended and a severance tax in a total amount of 2.3 cents was prescribed, to be effective until August 1, 1960. What the amount of tax will be from and after that date is not now known. With both the amount of the tax and its statutory basis thus being fluid, the only valid basis for price comparisons is the one comparable element, i.e., the initial base price.

could purchase this gas (Brief before the Commission at p. 2):

"... We fully appreciate the sincerity and diligence of Hope's efforts to obtain the least deleterious terms possible in that climate. We are not unaware that any endeavors to obtain less drastic prices were doomed to failure from the outset...."

Mr. J. J. Schmidt, Hope's Vice President in charge of gas procurement who negotiated these contracts, testified that these prices were less than initial prices in many recently-executed contracts in the area and less than the price currently being offered for gas in that area (R. 1169; see, also, 1310-1311).¹² In addition, Mr. Schmidt testified that the 21.5-cent price had already been established in the area before he undertook to negotiate for this gas (R. 1170-1171):

"... Southern Natural Gas Company, during 1957, entered into a series of gas purchase contracts which were certificated in Docket G-13082, *et al.* at an initial price of 21.5¢ with fixed escalations of 2¢ per Mcf each four years thereafter. The Southern contracts also contained favored nation clauses and price redetermination after the first four-year period and each four years thereafter. In addition, gas purchase contracts supporting a recent application of Transcontinental Gas Pipe Line Corporation were certificated in Docket No. G-13143, *et al.* at initial prices of 22¢ with fixed periodic escalation of 2¢ per Mcf every four years. Further, gas purchase contracts supporting a recent application of Trunkline Gas Company were certificated in Docket No. G-15394, *et al.* at initial prices of

¹² Mr. Schmidt also recounted the difficulties he had had in negotiating for this gas at the 21.5-cent price. According to his testimony, this price was not accepted by J. Ray McDermott & Co., Inc. (the operator of the largest block of gas here involved) or the other producers until after many meetings and extended negotiations; "After 18 meetings, we finally got them to sign up." (R. 1232-1233).

22¢ with fixed periodic escalation of 2¢ per Mcf every four years.”¹³

In contrast to sales described above, the record in the instant case discloses that the contracts here involved contain no favored-nation clauses; provide for periodic increases of only 1 cent every four years; and for price re-determination only after eight years in some, and after twelve years in others. Since such clauses are, in major part, responsible for the vast number of rate increases filed by independent producers, the limited and restrictive escalation clauses in the contracts here involved will be highly beneficial to the purchaser and ultimate consumer. See *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956). These advantages were fully recognized by the Commission (R. 4733).

In addition, Commission Staff's Exhibit 32 (R. 3410-3417) shows that, as of May 1959, there were many contracts which had been certificated for sale in interstate commerce which contain initial base prices equal to, or in excess of, the initial base prices here involved and which contain other pricing provisions which are less favorable to the purchaser and ultimate consumer than those contained in the Hope contracts. It is to be noted that Exhibit 32 covers sales in only the 6 parishes from which Hope was to purchase its gas in this proceeding and, therefore, does not reflect all of the interstate sales in the more than 25 parishes which comprise the general pricing area of southern Louisiana. Nor does the Exhibit reflect any intrastate sales which were being made in this area at higher prices.

This evidence, which is uncontroverted, fully justified

¹³ Judicial review was not sought with regard to the certificates issued for the sales to Southern Natural (19 FPC 558 (1958)) and these certificates are now final. Petitioner sought review of the certificates issued for the sales to Trunkline (21 FPC 704 (1959)), but this Court recently dismissed the petition for review. *Public Service Commission of New York v. FPC*, D.C. Cir. No. 15,365, decided April 28, 1960. The certificates issued for the sales to Transcontinental are the subject of the *Transco-Seaboard* litigation.

the Commission's finding that "... [t]he prices to be paid by Hope will set no new plateaus either offshore or in the onshore fields..." (R. 4733)

Petitioner's assertion that 17 cents was the "pre-CATCO" level of prices in southern Louisiana (Pet. Br., pp. 7, 17) is wholly without merit and has no support either in the record or in fact. The Commission's opinion dealt with this assertion and pointed out that, as far back as 1953, it had issued a certificate to Gulf Interstate Gas Company which, it knew, was to pay producers in southern Louisiana an initial base price of 20 cents per Mcf (plus tax reimbursement).¹⁴ After the *Gulf Interstate* case, the initial base price of 20 cents per Mcf became the "going price" for major packages of gas in that area. In evidence of this, the Commission's opinion, in the instant case, refers to the many producers in the southern Louisiana area who were certificated during 1954 and 1955 to sell gas under contracts also providing for an initial base price of 20 cents per Mcf (plus tax reimbursement).¹⁵ Petitioner

¹⁴ 12 FPC 116 (1953).

¹⁵ The Examiner's Initial Decision in one of these cases, involving the sale of gas to Texas Gas, summarizes the uncontroverted testimony in that proceeding relating to the "going" or "current" price of gas in southern Louisiana during early 1955 as follows:

"The principal negotiator for California¹⁵ stated that at the time he was negotiating with Texas Gas he knew the market was 20¢ and that was what he was trying to get but that he started negotiations 'a little above that.' His testimony was in part as follows:

'Well, we knew that contracts had been offered and had been made for 20 cents, with a 2½ cent every year escalation. We knew that other contracts had been at 20¢ with a 1 cent every five years escalation.

'Some of those contracts had already run several months, which is placing us at that particular point of negotiation closer to the point of escalation in their contracts.

'So there again we were trying to get the market. I think I was shooting for 22¢, which represented, as we could see it at that time, the current market price.'

"During the period of negotiations between the parties, it appeared to the senior vice-president of Texas Gas that the market was such that 'Every producer, large and small knew that the price for gas was 20 cents,

does not dispute the statements of the Commission but rather attempts to cast them aside as being totally unrepresentative and unique.

The Commission also noted that, taking into account the 20% inflation since at least 1954, a 20-cent initial base price in 1954 is comparable to a 24-cent price in 1959 and, hence, on this basis as well, the prices paid by Hope are "in line" (R. 4735-4736). Petitioner complains that these observations are improperly founded upon speculation and "unsupported 'iffy' premises" (Pet. Br., pp. 30-31). But the 20-cent prices referred to are reflected in the Commission's own decisions and the 20% inflation figure was expressly derived from publications of the U. S. Bureau of Labor Statistics (see R. 4736, fn. 6);¹⁶ official notice of such documents plainly is beyond cavil.¹⁷

Similarly free from objection is the fact, which the Commission also noticed and which Petitioner does not dispute,

regardless of whether they paid 16 for some smaller contracts; but they paid 20 cents and that was the price that the producers knew about.'

"In this connection, the witness referred to a 20 cent price paid by United Gas Pipe Line Company in a contract in the Duck Lake Field 'which is about 12 to 15 miles immediately east of East Lake Palourde and Amelia, that went to 20 cents in 1955—November 1 of 1955,' to a 20 cent price paid by American Louisiana Pipe Line Company 'over in the western part of the State,' and to a 20 cent price paid by 'Gulf Interstate.'

¹⁵ See testimony of Harold D. Brennand, Manager of Crude Oil, Natural Gas and Plant Products Sales for California."

Atlantic Refining Co., et al., Docket Nos. G-8809, *et al.* (issued December 7, 1955), 14 FPC 480, 484. The Examiner's Decision was affirmed by the Commission without modification (14 FPC 490); see, also, *American Louisiana Pipe Line Co.*, FPC Opinion No. 276 (issued October 1, 1954).

¹⁶ In its Petition for Rehearing, Petitioner had no objection to the 20% figure provided that it was applied to its version of the appropriate base figure. (See R. 4754).

¹⁷ It should be noted that, in contrast to this complaint, Petitioner has itself taken far greater liberties in its discussion of the alleged history of producer prices in southern Louisiana. (See Pet. Br., pp. 12-27).

that the instant gas is produced from deep horizons and in almost inaccessible areas (R. 4736). In referring thereto, the Commission was properly drawing upon its knowledge and expertise regarding the gas production business. *United States v. Pierce Auto Freight Lines*, 327 U.S. 515, 530 (1946); *Market Street R. Co. v. Railroad Commission of California*, 324 U.S. 548, 561, 562 (1945).

Moreover, these references in no way prejudiced Petitioner. They were made after the Commission had already concluded that the instant prices were "not out of line with other prices currently being charged in Louisiana" (R. 4733, 4736) and after it had held that *CATCO* did not require it to look only at pre-*CATCO* prices (R. 4735). Their primary purpose was to demonstrate the fallacy of Petitioner's assertion that 17 cents per Mcf reflected the pre-*CATCO* level in southern Louisiana and to show that, with appropriate adjustments, the present prices are "in line" with even pre-*CATCO* prices. In any event, these observations did not go to the Commission's basic finding and, therefore, the error, if any, was harmless. *United States v. Pierce Auto Freight Lines*, *supra*.

2. The Instant Prices Will Not "Trigger" Any General Price Rises

In contrast to the situation in *CATCO*, the evidence here is clear and uncontroverted that, as the Commission found (R. 4733, 4736), no triggering of any general price rises will result from the producer initial prices here involved. These prices can have no impact upon prices paid by Hope under other contracts since these are the first contracts entered into by Hope in the southern Louisiana area. Furthermore, they will have no impact upon the prices in contracts of other purchasers for, as shown *supra*, pp. 12-14, there are many contracts in this area containing prices equal to, or in excess of, those contained in the instant contracts.

3. The Producer Prices Will Not Result in an Increase in Hope's Rates

Again, unlike in *CATCO*, the Commission's finding that certification of the producer prices will not cause any "increase in Hope's existing rates to its customers" (R. 4736) is supported by substantial evidence. Mr. Lloyd A. Scott, Hope's Manager of Rates, testified (R. 1637):

"Q. With respect to all applications involved in this proceeding, that is, the pipeline applications and the independent producer applications, will the proposed transportation service and the proposed producer sales require an increase in the rates by Hope Natural to its affiliates?

"A. No, it will not.

"Q. And do I correctly understand you to testify that in your considered judgment the granting of all of the applications in this consolidated proceeding will not have an adverse financial impact upon the customers of Hope Natural Gas Company?

"A. That is correct."

Mr. Francis Wright, Manager of the Rate Department for The East Ohio Gas Company, which would probably purchase 50% of the gas here involved (R. 1199, 1563), further elaborated (R. 1588-1589):

"... I can't see how when Hope is charging East Ohio 50.63 cents and in the future considering the gas in this case, with an additional 100 million a day or 36 billion cubic feet annually rolled into Hope's sales at something like a cost of 45 cents, that seems to me almost axiomatic that the only result could be a lower rate from Hope to East Ohio.

"Q. Then in your opinion the answer to the question would be that you cannot foresee how they could increase their rate to you as a result of their acquiring the gas involved in this proceeding, is that correct?

"A. Yes."

Despite the fact that Petitioner did not cross-examine either Witness Scott or Witness Wright concerning these clear

and positive statements, or present rebuttal evidence of any kind, Petitioner nevertheless insists that, since the weighted average cost of the instant gas is about 44.825 cents per Mcf whereas the weighted average cost of Hope's pipeline-purchased gas is estimated for 1960 at about 37.5 cents and that of its Appalachian gas at about 24.05 cents, this new gas must necessarily and inevitably increase Hope's gas costs and rates (Pet. Br., p. 32). "[I]ncreased gas costs," says Petitioner, "*always lead to increased gas rates*" (*ibid.*) (*italics in original*).

This argument, although having a superficial plausibility, is founded upon the erroneous premise that Hope's costs of these two supplies of gas are comparable. This is not true. On the one hand, the price paid by Hope to its pipeline suppliers, being solely for gas which is transported, stored, and later delivered by Hope to its customers in time of greatest need, is in reality a "raw" price. To this must be added the substantial costs of the further and *additional* services, such as storing, transporting and handling, which are provided by Hope and which are reflected in the spread between Hope's cost of pipeline-purchased gas and its resale rates.¹⁸ On the other hand, Hope will not incur any additional costs in connection with the gas here involved. Since Texas Eastern will deliver the gas, on Hope's behalf, directly to Hope's customers (R. 1563), no additional facilities, services or handling by Hope will be required (R. 1551, 1566). Thus, the 44.285-cent average price paid for this gas reflects Hope's *total* cost of the gas delivered to the other Consolidated Companies. In these circumstances, to compare the total cost to Hope of selling the gas supply here involved to its affiliated companies with

¹⁸ Hope's currently effective rates to its resale customers are (R. 1549):

The East Ohio Gas Company	50.63¢ per Mcf
New York State Natural Gas Corporation	48.19¢ per Mcf
The Peoples Natural Gas Company	48.19¢ per Mcf
The River Gas Company	48.19¢ per Mcf

its "raw" cost of pipeline-purchased gas is like comparing apples with oranges.

4. The Public Served by Hope Urgently Needed Additional Supplies of Gas

Finally, in contrast to *CATCO*, the record here contains detailed evidence showing the needs of the Consolidated System for additional supplies of natural gas by the winter of 1959-1960 to meet the growing requirements of its existing markets in the Appalachian area. This evidence of market requirements, which is uncontroverted in this appeal, shows that, by the winter of 1959-1960, the Consolidated Companies urgently needed the gas here involved (R. 1171-1172, 1182, 1189, 1571 and 3220).¹⁹

The System's urgent and admitted need for this new supply of gas strongly reinforces the propriety of the Commission's issuance of certificates to the producer applicants at the initial prices here involved.

II

NEITHER *CATCO* NOR *TRANSCO-SEABOARD* REQUIRES A "ROLL BACK" TO THE ALLEGED PRE-*CATCO* LEVEL OF 17 CENTS PER MCF

While freely conceding that the initial prices here are "in line" with the prices now prevailing in southern Louisiana, Petitioner nevertheless claims that these prices are "out of line" under *CATCO* because, according to Petitioner, the Supreme Court in *CATCO* and *Transco-Seaboard* invalidated the prices allowed in these cases and hence precluded the Commission from taking into account prices allowed subsequent to the Commission's order in *CATCO* in determining whether a producer's proposed price is in line.

¹⁹ This evidence of the Consolidated System's need for the additional 100 million cubic feet a day is borne out by the fact that, during the past winter of 1959-1960, this gas has been delivered to Hope's sister companies in the Consolidated System and has been utilized by them in meeting the needs of the consumers served by them.

A. Petitioner's Construction of CATCO is at Odds with Fundamental Principles of Judicial Administration and Power

As shown, *supra*, pp. 8-9, *CATCO* holds (1) that, in order to achieve the Act's purpose of protecting the consumers, the Commission should, in exercising its discretion in certificate proceedings under Section 7(e) of the Act, carefully scrutinize the proposed initial price with a view to holding the line against price rises, and (2) that the evidence in the record in that case was insufficient to justify the issuance of certificates at the 21.4-cent base price there involved. The Supreme Court, moreover, set aside the Commission's allowance of the 21.4-cent base price in *CATCO*, not because that price was invalid *per se* and hence prohibited under any and all circumstances, but rather because the evidence in the record was insufficient to support its allowance—an insufficiency which the Commission itself had recognized in its first two *CATCO* orders (17 FPC 563, 575 (1957) and 17 FPC 732, 733-734 (1957)). Since the Supreme Court's action in *CATCO* was thus predicated on deficiencies in the record and does not preclude the allowance of the 21.4-cent price on a different and adequate record, it follows that *CATCO* does not contain a mandate requiring that initial prices of producers be rolled back to the alleged pre-*CATCO* level of 17 cents per Mcf.

Petitioner's attempt to convert *CATCO* into a far broader ruling not only is not supported by *CATCO* but runs afoul of settled doctrines of judicial administration and power.

1. The Supreme Court did not Pass Upon Prices in Southern Louisiana Generally

Petitioner asserts that the Supreme Court was aware that, prior to its *CATCO* decision, the Commission, in numerous other certificate proceedings, had authorized sales at prices comparable to the *CATCO* price. Consequently, Petitioner contends (Pet. Br., p. 21; see, also, Pet. Br., p. 28) that the Court's observation that prices in

southern Louisiana "have now vaulted from 17 cents to over 23 cents per MCF" (360 U.S. 378, 390) manifests a disapproval of the use of these prices as a basis for determining the "in-line" level.

Petitioner's argument necessarily assumes that not only has the Court passed on the validity of prices not in issue before it, but it has done so without the benefit of the evidence of record in the proceedings in which these prices have been allowed. Such an assumption flies in the teeth of established principles of judicial administration and certainly could not provide a sound basis for expanding the purport of the Court's passing observation with regard to southern Louisiana prices.

2. The Court did not Invade the Administrative Sphere by Fixing the Proper Rate

Petitioner also suggests that, in *CATCO*, the Supreme Court must have intended to fix initial producer prices at the alleged pre-*CATCO* level; otherwise, according to Petitioner, the Court would have been speaking in a vacuum. (Pet. Br., p. 29)

Plainly, however, there can be no question that *CATCO* involved an actual controversy, i.e., whether the Commission properly issued unconditioned certificates to the producer applicants there involved. And in deciding that controversy, the Supreme Court both provided criteria for the Commission's guidance in issuing producer certificates and held that the Commission's factual findings were not supported by adequate evidence. See, *supra*, pp. 8-10. Decisions by the Supreme Court of comparably limited scope are not at all uncommon. See, e.g., *Universal Camera Co. v. National Labor Relations Board*, 340 U.S. 474 (1951); *Schaffer Transportation Co. v. United States*, 355 U.S. 83 (1957); *Rowoldt v. Perfutto*, 355 U.S. 155 (1957); *Chicago, Milwaukee, St. Paul & Pacific Railroad Co. v. State of Illinois*, 355 U.S. 300 (1958).

In contrast, to accept Petitioner's claim that the Supreme Court went further and prescribed a specific price of 17 cents, which did not represent the pre-CATCO "going price" (see, *supra*, pp. 14-15), for certificating producer sales, requires disregard of settled constitutional limitations upon judicial power. For such fixing of price involves the legislative power of rate making, beyond the authority even of Congress to vest in the Supreme Court. *Keller v. Potomac Electric Power Co.*, 261 U.S. 428, 441-446 (1923); cf. *Newton v. Consolidated Gas Co.*, 258 U.S. 165, 177 (1922). Because of this limitation, Supreme Court review of rate determinations has traditionally been restricted to the judicial questions of whether the rates involved comply with constitutional and statutory requirements. Where they do not so comply, the Court has uniformly remanded the case for further action by the administrative body in compliance with the Court's decision and has, itself, carefully refrained from expressing any views as to the proper rate. See, e.g., *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276 (1923); *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923); *United Railways & Electric Co. v. West*, 280 U.S. 234 (1930). Such, we believe, is what the Supreme Court did in CATCO.

3. The Rate Level Applied by the Commission does not "Nullify" CATCO

Petitioner finally claims that to allow the prices authorized in certificates granted between decisions of the Commission and the Supreme Court in CATCO to be used for testing prices in new applications results in nullification of CATCO (Pet. Br., p. 30).

This contention is predicated on Petitioner's reading of CATCO, which we have already shown to be erroneous. In this connection, it should also be noted that, contrary to Petitioner's assertion (Pet. Br., pp. 22-23), the Commission, in acting on certificate applications since CATCO, has

scrupulously adhered to its teachings. In accordance therewith, the Commission has carefully scrutinized initial price proposals of producers and, where found to be out of line, has either denied the application or imposed appropriate rate conditions. Indeed, in this very case, the Commission, at the same time that it found the prices here involved to be "in line," admonished (R. 4736):

"We shall consider any new application based upon a price in excess of any price we have heretofore certificated to be 'out of line' and shall require conclusive proof from the applicant that the public convenience and necessity requires certification at that price."

In conformity with the above-announced policy, the Commission, in an opinion issued on the same day as the opinion here involved, August 10, 1959 (*Transwestern Pipeline Co.*, 22 FPC 391), found that the proposed initial prices exceeded the prevailing level in that area.²⁰ Expressly adverting to *CATCO*, the Commission held that the public convenience and necessity required it to "hold the line" on further price increases and, accordingly, imposed conditions reducing the producers' initial prices to the level existing in those fields.²¹ In *Phillips Petroleum Co.*, 22 FPC 694 (1959), the Commission similarly found that the proposed initial prices were "out of line" and imposed a condition reducing the price. See, also, *El Paso Natural Gas Co.*, FPC Opinion No. 335, issued February 23, 1960 (not yet reported); *Western Natural Gas Co.*, FPC Docket Nos. G-16099, *et al.*, Order issued February 15, 1960 (not yet

²⁰ Significantly, Petitioner's discussion of the opinions and orders issued by the Commission in early August 1959 (Pet. Br., pp. 22-23), does not refer to *Transwestern*.

²¹ Upon application for rehearing, the Commission reopened the record to permit the producers to attempt to justify the proposed prices, 22 FPC 542 (1959). These supplementary proceedings are now pending before the Commission and no decision or opinion has been issued.

reported); *Gulf Oil Corporation*, FPC Docket Nos. G-17973, *et al.*, Order issued May 9, 1960 (not yet reported).

Since the Commission is thus carefully applying the "hold the line" precepts of *CATCO*, Petitioner's claim of "nullification" becomes merely a disagreement as to the appropriate line. Petitioner claims that the proper line is that prevailing when the Commission decided *CATCO*, whereas the Commission has undertaken to hold the line at the level as of the time of the Supreme Court's decision. In selecting this level at which to hold the line, the Commission, in effect, duplicated the action taken by it following the Supreme Court's decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954). Although the result of the *Phillips* ruling was that producer sales of gas had been subject to Commission regulation since the enactment of the Natural Gas Act in 1938, the Commission realistically accepted producer rates in effect as of the time of the Supreme Court's decision and undertook to impose regulation as of that date. Just as there is no question as to the propriety of the Commission's action there, so also is there no question as to the legal and practical soundness of the Commission's holding the line on producer prices as of the date of the Supreme Court's decision in *CATCO*.

B. Transco-Seaboard does Not Contain Any Rulings on the Merits and does Not Require Price "Roll Back"

In support of its claim of a price "roll back", Petitioner also relies heavily upon the Supreme Court's *per curiam* opinion in *Transco-Seaboard* where, in an order issued prior to the Supreme Court's *CATCO* decision, the Commission had authorized several producers to sell gas at initial base prices ranging from 21 cents to 22 cents per Mcf (exclusive of tax reimbursement). (20 FPC 264 (1958))

In that case, the Third Circuit undertook to apply the Supreme Court's *CATCO* decision which had been rendered while the case was pending before it on appeal, and,

on this basis, affirmed the Commission. *United Gas Improvement Co. v. FPC*, 269 F.2d 865. One judge (Hastie) dissented; while he did not disagree with the majority's substantive analysis of *CATCO*, he was of the view that the case should be remanded to the Commission since it had the primary duty of determining whether it would reach the same result in light of *CATCO*. (269 F.2d at 870)

Upon certiorari, the Supreme Court, we submit, agreed with the dissenting judge. In its *per curiam* opinion, the Supreme Court directed (361 U.S. 195):

"The petition for a writ of certiorari is granted. The judgment of the Court of Appeals is vacated and the case is remanded to that court with directions to remand the case to the Federal Power Commission for reconsideration and redetermination in light of *Atlantic Refining Co. et al. v. Public Service Commission of New York*, 360 U.S. 378."

In so acting, the Supreme Court did not, contrary to Petitioner's repeated assertions (Pet. Br., pp. 23-24; 28-29), render any decision on the merits of the case. Rather, it followed its common practice, in situations where it has rendered an intervening decision bearing on the general problem, of remanding the case for reconsideration in light of that decision.

That this practice does not involve any substantive ruling on the part of the Supreme Court is apparent from the *Barenblatt* decisions. In that case, this Court initially affirmed Barenblatt's conviction for contempt of Congress based on his refusal to answer certain questions propounded by the House Un-American Affairs Committee. *Barenblatt v. United States*, 100 U.S. App. D.C. 13, 240 F.2d 875 (1957). Shortly thereafter, the Supreme Court in *Watkins v. United States*, 354 U.S. 178 (1957), reversed a comparable contempt conviction. As a result, when *Barenblatt* came before it, the Supreme Court rendered a *per curiam* opinion, virtually identical to that in *Transco-Seaboard*,

remanding the case for consideration in light of *Watkins*. (354 U.S. 930 (1957)).²²

Upon remand, this Court clearly did not view the *per curiam* opinion as making any substantive ruling. Had it so read the opinion, this Court might well have summarily reversed Barenblatt's conviction. Instead, this Court heard the case *en banc*, and, in a split decision, affirmed Barenblatt's conviction even though this result was contrary to that in *Watkins*.²³ (102 U.S. App. D.C. 217, 224; 252 F.2d 129, 136 (1958)):

"In accordance with the direction of the Supreme Court we have carefully considered *Watkins* and its impact on Barenblatt. Taking account of all circumstances as noted and believing the cases are distinguishable as indicated, we affirm the judgment of conviction."²⁴

²² The *per curiam* opinion in *Barenblatt* reads as follows (354 U.S. 930):

"The petition for a writ of certiorari is granted. The judgment of the Court of Appeals for the District of Columbia Circuit is vacated and the case remanded for consideration in light of *Watkins v. United States*, 354 U.S. 178."

²³ In view of Petitioner's attempt to infuse significance into the Supreme Court's alleged knowledge in *CATCO* of the prices allowed by the Commission in *Transco-Seaboard* and other certificate proceedings, it is noteworthy that, in *Barenblatt*, *supra*, this Court was confronted with a similar situation (102 U.S. App. D.C. at 219-220, F.2d at 131-132):

"... it is clear the [Supreme] Court [in *Watkins*] was familiar with the present case as it is specifically referred to in note 34 of the opinion in *Watkins*. The Court certainly knew, therefore, that Barenblatt's conviction grew out of testimony taken under the same resolution. Moreover, it is reasonable to assume that, had the resolution under which both *Watkins* and Barenblatt were questioned been stricken in its entirety, this case would have been reversed on authority of *Watkins* rather than remanded for consideration 'in light of' that opinion. . . ." (italics in original)

Similarly, here, if the Supreme Court in *CATCO* had intended to hold that producer prices such as those involved in *Transco-Seaboard* and here, were necessarily tainted and so could not be allowed, the Court would have reversed, rather than vacated the judgment in *Transco-Seaboard*.

²⁴ The dissenting judges did not take issue with the majority's reading of the Supreme Court's *per curiam* remand. To the contrary, Judge Edgerton's dissent explicitly recognized the absence of a substantive ruling therein. See 102 U.S. App. D.C. at 226, 252 F.2d at 138

Far from holding that this Court had failed properly to follow its remand, the Supreme Court accepted this Court's action; indeed, on the merits the Supreme Court agreed that *Barenblatt* was distinguishable from *Watkins*, and affirmed this Court's judgment (360 U.S. 109 (1959)).²⁵

The fact that in *Transco-Seaboard* the lower court's opinion was issued after the Supreme Court's decision in *CATCO* and the remand was for "reconsideration and redetermination" (italics supplied) in light of *CATCO* does not detract from the applicability of *Barenblatt*. For, unlike *Barenblatt*, *Transco-Seaboard* involved review of administrative action as to which primary responsibility lies with the Commission, and, as stated by the Supreme Court with regard to the comparable provision of the Interstate Commerce Act (*United States v. Detroit & Cleveland Nav. Co.*, 326 U.S. 236, 241 (1945)):

"The Commission is the guardian of the public interest in determining whether certificates of convenience and necessity shall be granted. . . . Its function is not only to appraise the facts and to draw inferences from them but also to bring to bear upon the problem an expert judgment and to *determine* from its analysis of the total situation on which side of the controversy the public interest lies." (Italics supplied)

With the granting of certificates under Section 7(e) thus being primarily for *determination* by the Commission, it becomes clear that the *Transco-Seaboard* remand is basically indistinguishable from that in *Barenblatt*. Since the Commission's order in *Transco-Seaboard* had been issued prior to the Supreme Court's *CATCO* decision, the Commission, in contradistinction to the Third Circuit, had not had an opportunity to take *CATCO* into account in deciding *Transco-Seaboard*. In these circumstances, the Supreme Court was unwilling to accept the Third Circuit's conclu-

²⁵ For recent series of similar rulings, see, e.g., *Uphaus v. Wyman*, 355 U.S. 16; 101 N.H. 139, 136 A.2d 221; 360 U.S. 72; *Joines v. United States*, 357 U.S. 573; 258 F.2d 471 (3rd Cir.); 358 U.S. 880.

sion that the Commission would have reached the same result under *CATCO*; rather it remanded the case to the Commission for "reconsideration and redetermination" in light of *CATCO*, in order to enable the Commission to determine the case afresh according to the precepts enunciated in *CATCO*. See, also, *SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943); *Sunray Mid-Continent Oil Co. v. FPC*, 353 U.S. 944 (1957).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Commission's order issuing certificates to the producer applicants at the proposed initial prices should be affirmed.

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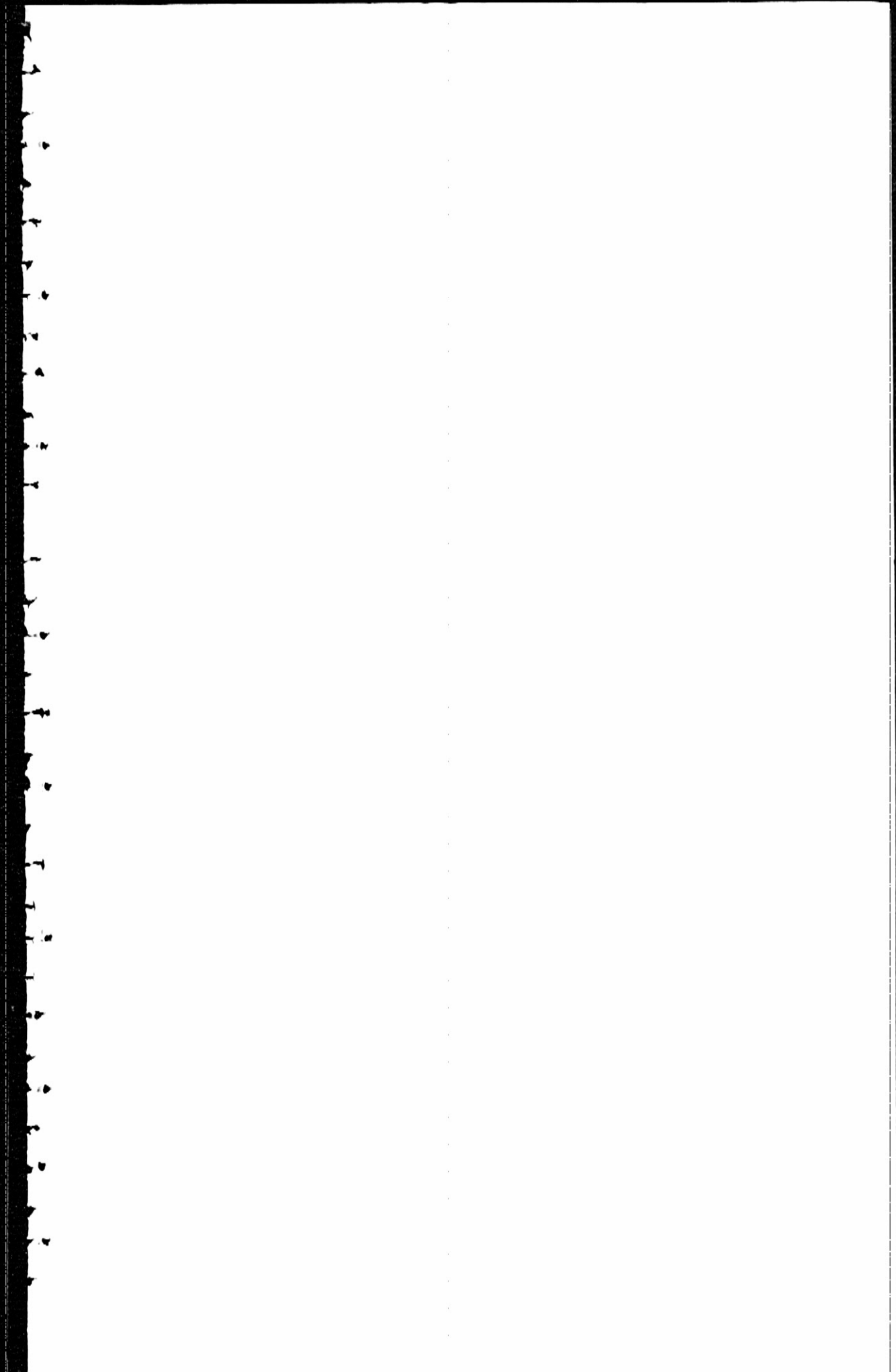
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2



REPLY BRIEF FOR PETITIONER.

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA ~~CIRCUIT~~.

No. 15461.

PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent,

TEXAS GAS TRANSMISSION CORPORATION, *et al.*,

Intervenor-Respondents.

ON PETITION FOR REVIEW OF AN ORDER OF THE
FEDERAL POWER COMMISSION

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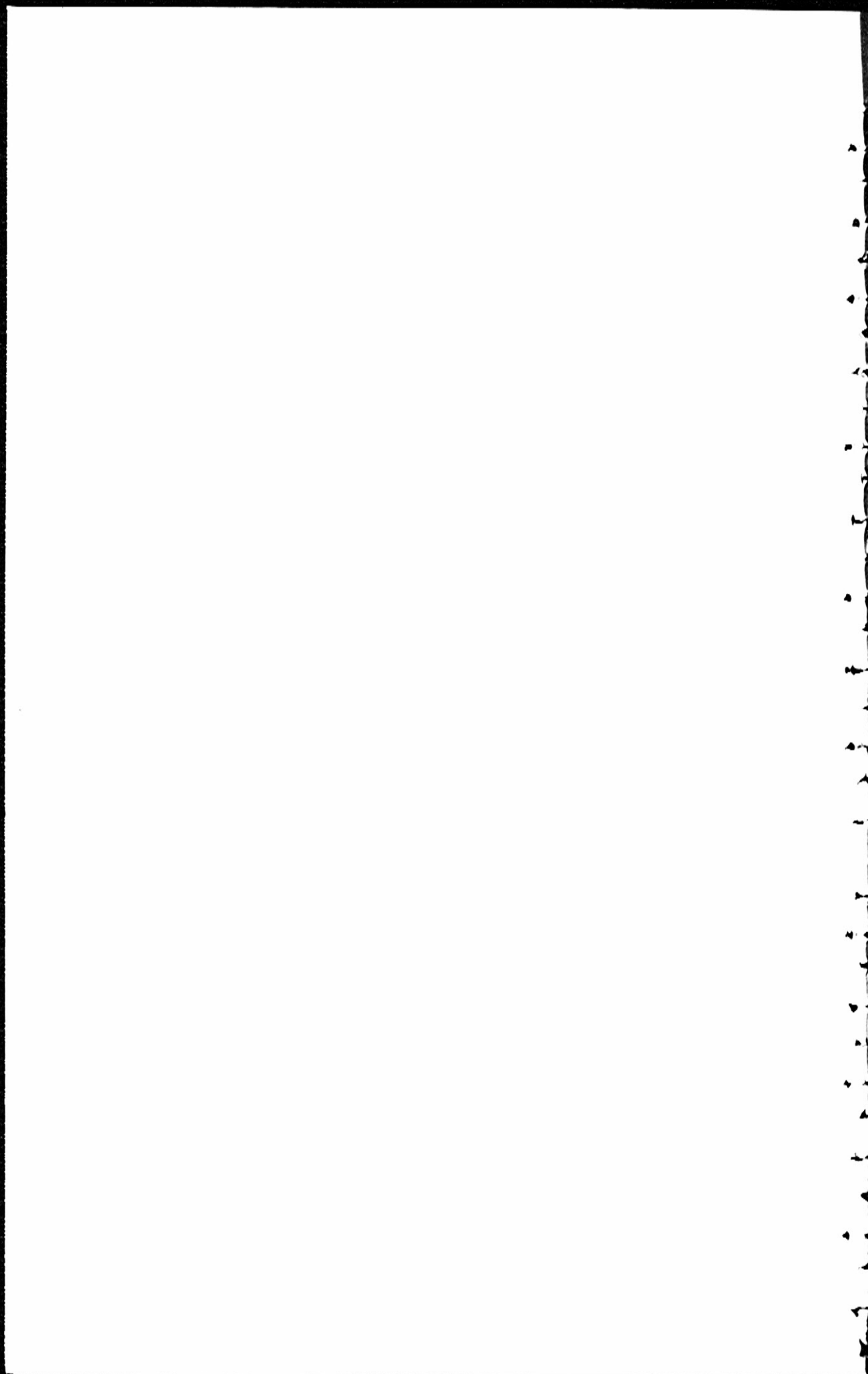


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IN THE
United States Court of Appeals
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No. 15461.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent,

TEXAS GAS TRANSMISSION CORPORATION, TEXAS EASTERN
TRANSMISSION CORPORATION, HOPE NATURAL GAS COMPANY,
TEXAS GAS EXPLORATION CORPORATION, J. RAY McDERMOTT
& Co., Inc., KILROY PROPERTIES INCORPORATED, THE
CALIFORNIA COMPANY, CALLERY PROPERTIES, INC., OCEAN
DRILLING & EXPLORATION COMPANY, HUMBLE OIL & REFIN-
ING COMPANY, AMERADA PETROLEUM CORPORATION, KERR-
McGEE OIL INDUSTRIES, INC., BEL OIL CORPORATION,
CAROLINE HUNT SANDS AND LOYD B. SANDS, RICHARDSON
& BASS (LOUISIANA ACCOUNT), OPERATOR, MAGNOLIA PETRO-
LEUM COMPANY, BECK OIL COMPANY, PHILLIPS PETROLEUM
COMPANY, MISSISSIPPI RIVER FUEL CORPORATION, UNION
OIL COMPANY OF CALIFORNIA, TIDEWATER OIL COMPANY,
CONTINENTAL OIL COMPANY, SHELL OIL COMPANY, PAN
AMERICAN PETROLEUM CORPORATION,

Intervenor-Respondents.

REPLY BRIEF FOR PETITIONER.

Introduction.¹

Essentially the sole issue in this case is whether the record below contains sufficient evidence to support respondent's determination that public convenience and necessity has been shown to require producer initial prices of 23.05¢ and 23.55¢ per Mcf for the instant sales.² Respondent and the intervenor-respondents insist upon attributing to petitioner other issues, contentions and positions we do not here espouse and never have espoused. Having demolished these imputed arguments of their own creation, they would seek to create the impression they have responsively met and definitively disposed of the actual issue before this Court, when in reality no producer nor any of his associates herein has advanced, either before the respondent Commission or this Court, any "reason why" it is "convenient" or "necessary" for the public to pay him the price he demands for the commodity he seeks to introduce into the interstate market.

The basic thesis of respondent and of the Hope-intervenors is simply that—notwithstanding the Supreme Court's reversal, on June 22, 1959, of Catco's unsupported 22.4¢ initial price certifications as "out of line"—FPC had "discretion" on August 10, 1959, to declare similarly unsupported producer initial prices of 23.05¢ and 23.55¢ *not* to be "out of line" and to issue unconditional producer certificates therefor *without the evidentiary justification demanded by the Supreme Court in respect of the lower*

¹ This brief refers to FPC as "respondent", to Hope, Texas Gas and Texas Eastern as the "Hope-intervenors" and to the other parties as the "producer-intervenors". References to "respondents" are intended to include all of the intervenors as well as FPC.

² We request the Court to ignore all attempts to fragmentize these prices into "base" and "tax compensation" components (See Hope Br. p. 11, fn. 11). It is undisputed, at least for the purposes of this case, that the total prices are 23.05¢ and 23.55¢ per Mcf. It is that total initial cost which flows inexorably down the pipeline with the gas to the consumers' doorstep. To the extent that the instant producer applicants receive greater "tax compensation" than others receiving 21.0¢ or 21.5¢ "base" prices for their gas, their prices simply are not comparable. Moreover, since the 23.05¢ and 23.55¢ *total* prices were *not* justified on a cost basis, it seems grossly improper to segregate out some portion that has an indisputable cost justification and thereby speciously to minimize the totals.

Catco prices. The producer-intervenors apparently join in this thesis in part (Prod. Br., pp. 13-14 [numbered paragraph 2]) and revert, in part, to their familiar, twice discredited, *Catco* and *Transco-Seaboard* theme that various other admirable features of the transaction somehow confer an aura of public convenience and necessity upon the proposed producer prices in spite of the complete absence of evidence in this record to demonstrate their propriety *per se* (Prod. Br., pp. 13-15 [numbered paragraphs 1, 3-10]). All are agreed that the Supreme Court's *Transco-Seaboard* decision has no "substantiative" significance whatever on the issue here presented (FPC Br., pp. 17-18, Hope Br., pp. 24-28; Prod. Br., pp. 20-21).

As the first step in their endeavor to contort the patently irreconcilable Supreme Court decisions into conformity with the FPC determination here on review and with the FPC-Hope thesis here presented, respondent and the Hope intervenors would have this court believe: (1) that this petitioner requested the *Catco* Court to direct an indiscriminate "roll back" of all southern Louisiana initial prices to 17 or 18¢ per Mcf levels; (2) that this petitioner lost on that point before the Supreme Court; (3) that the Supreme Court, having denied petitioner's request for a price "roll back" from 22.4¢ to 17 or 18¢, *ipso facto*, impliedly countenanced a price "roll forward" from the unsupported 22.4¢ *Catco* levels to the equally unsupported 23.55¢ levels certificated here, and beyond; (4) that petitioner, having been defeated in *Catco*, again "solicits" from this Court the same improper "judicial usurpation of the Commission's task of economic decision-making" it sought in that case; and (5) that, therefore, this Court would give effect to the Supreme Court's *Catco* teachings if it denied that "solicitation" and affirmed, instead, respondent FPC's thesis and 23¢-plus unconditional certifications in this case (FPC Br., pp. 1-2, 7, 8-16; Hope Br., pp. 5-7). None of this is remotely borne out by the facts.

This court should thoroughly understand—as does every participant in this case—that petitioner *never* requested of the Supreme Court, and does *not* now request

of this Court, a generalized and wholesale judicial edict "rolling back" or rigidly pegging producer initial prices to some predetermined fixed level regardless of the evidentiary support (if any) for a different level.

Having urged the Supreme Court to negate a "just and reasonable" requirement in producer certificate cases, we simply and solely asked that Court, instead, to impose a requirement under which *some* reasonable demonstration of public convenience and necessity must be forthcoming before any particular producer may be permitted to occasion a boost in the pre-Catco, going initial price "line" for interstate sales. That requirement is precisely what we obtained. That demonstration is precisely what the producers failed to furnish in the proceeding below. That is precisely why the unconditional certificates issued here—without producer explanation of the "reasons why" public convenience and necessity requires a boost even beyond the "out of line" Catco initial price level, much less beyond the pre-Catco "in line" level—were issued in error.

Petitioner did urge *the Commission* to impose an initial price condition in this case based upon the mean or weighted average of *all* previous, lawfully certificated southern Louisiana producer initial prices. That approach, of course, would not have permitted reliance (much less *exclusive* reliance) on the recently overturned Catco prices themselves or on similar prices certificated between June 24, 1957 and June 22, 1959 solely on the authority of the Commission's erroneous, Catco-founded producer price principles (i.e., the Catco progeny). It would, however, have given due weight to the overwhelming majority of southern Louisiana prices at 18¢ or below *as well as* to those few pre-Catco sales at 20 and 21¢ initial price levels which, according to Opinion 321 and the Hope intervenors, are the *only* pre-Catco sales worthy of consideration as representative of pre-Catco, southern Louisiana, initial price conditions (Hope Br., p. 14; R. 4735). As a mathematical proposition, that approach would have yielded an initial price condition at a total of approximately 18¢ per Mcf. Our requested conditioning method was one introduced,

developed and advocated by Commissioner Connole,³ whose dissenting opinions in *Catco*, *Transco-Seaboard* and numerous other FPC producer certificate decisions had received striking vindication in the Supreme Court's *Catco* opinion, issued just a few days before the close of the hearing below. That our requested condition would have been *one* legally permissible resolution of this proceeding, we think there can be no doubt. Though we never claimed it to be *the* (sole) legally permissible resolution, in our view it would have been an eminently fair and reasonable one in view of the absence of evidence to establish the public convenience and necessity of the producers' proposed prices. However, the Commission did not grant our request. Instead, on the heels of the Third Circuit's *Transco-Seaboard* decision, it unconditionally authorized the unsupported initial prices demanded by the producers. We are *not* here, as respondents would suggest, to urge upon this Court the *wisdom* of the action (18¢ initial price condition) the Commission did *not* take. We are here, just as we were before the courts in *Catco* and *Transco-Seaboard*, *only* to contest the *legality* of the action (23.05¢ and 23.55¢ unsupported and unconditional certifications) the Commission *did* take. To dispute the wisdom of the former is not, as respondents imagine, sufficient to prove conclusively the legality of the latter.

The Commission's action, we submit, is not now and never was remotely compatible with or permissible under the strictures of the high Court on the subject of the respondent's regulatory obligations under Section 7 of the Natural Gas Act. It (and each of its five companions of August 10, 1959) was expressly motivated and inspired by and is wholly dependent upon, the decision of the Third Circuit in the *Transco-Seaboard* case. That decision, much as respondents would like to have it otherwise, was not affirmed nor left undisturbed by the Supreme Court. It was emphatically overturned, and with it must fall its present dependent.

³ See his dissenting opinion in *Seaboard Oil Company, et al.*, Doc. Nos. G-11970 *et al.*, Opinion No. 309, 19 F. P. C. 416, at pp. 427-36.

ARGUMENT.

POINT I.

Respondent's issuance of the instant certificates is in conflict with, and subversive of, the Supreme Court's *Catco* decision.⁴

As its opinion reveals, the Supreme Court, in setting aside FPC's 22.4¢ *Catco* certificates, was fully cognizant of respondent's numerous post-*Catco* unconditional certifications at equal-to or higher-than-*Catco* initial prices⁵ as well as of its relatively few pre-*Catco* unconditional certifications at 20 and 21¢ levels.⁶ The Court was informed, exhaustively and repeatedly, of each and every one of those certificated prices by the 5 producer and pipeline petitioners (including Continental and Tidewater, producer-intervenors here), by their supporting *amicus curiae* (FPC) and by the 3 respondents (including PSC) in that case, each of whom relied, for different reasons, on the Commission's producer price certification history to support its position.

⁴ *Atlantic Rf'g Co. v. Pub. Serv. Comm'n*, 360 U. S. 371 (June 22, 1959).

⁵ Of these, only 14, representing sales to Southern Natural Gas Company, are not now either in some stage of judicial review or still subject to judicial review or on remand or rehearing before the Commission. PSC was excluded by FPC from participation in certificate proceedings involving Southern Natural on the grounds (1) that its intervention in opposition to the high producer initial prices in those proceedings would not be "in the public interest" and (2) that PSC would not be "adversely affected" by the producer initial prices authorized for those sales because the gas involved was destined to markets other than New York's. (*Southern Natural Gas Co., et al.*, Doc. Nos. G-11234, *et al.* Order of June 20, 1957 [unreported]). The latter assurance has been violated repeatedly by respondent. We request that it be enforced in this proceeding, at least to the extent of this Court's refusal to permit those certifications to be urged or considered in any way, in opposition to PSC's position herein (Hope Br. p. 13, fn. 13).

⁶ Contrary to Hope's claim that "many" producers obtained certificates for 20¢ (ex tax) sales prior to *Catco* and in 1954 and 1955 (Hope Br. p. 14), there were, as the Supreme Court was aware, only three groups of sales at those price levels in contrast to the scores, if not hundreds, of producer certificates issued by respondent in those years for sales at 18¢ and below (See PSC Br. p. 16).

With this knowledge, the Supreme Court nevertheless found the Catco prices, at 22.4¢ per Mcf, to be "out of line". It remanded the Catco proceeding to the Commission for one of two things: (1) its imposition of initial price conditions *reducing* the 22.4¢ charge therein proposed; or (2) its insistence that the Catco applicants furnish proof that their price proposals were consistent with or required by the present or future public convenience and necessity.

None of the foregoing is denied by the respondents. Indeed, FPC expressly acknowledges that "the prices in Catco were 'out of line' by the Commission's present standard as well as PSC's" (FPC Br. p. 17). Nevertheless, each respondent insists that the instant prices, at higher-than-Catco levels are not "out of line" and that, therefore, they were properly exempted by the Commission from the Supreme Court's *Catco*-imposed conditioning or evidentiary requirements.

To support this remarkable conclusion the intervenor-respondents rely principally on the very same producer price certification decisions that were urged upon, and with which they were unsuccessful in persuading, the Supreme Court to find the lower Catco prices "in line" (Hope Br. pp. 11-14; Prod. Br. pp. 3-5). In this respect, petitioner submits, these parties offer not legal argument but simply contradiction of the Supreme Court's decision. This Court should not be called upon to entertain the resumption of their dispute with that tribunal.

The respondents also cite the Commission's recent imposition of initial price conditions in *some* producer certificates authorizing sales from *other* (non southern Louisiana) producing areas, as a factor that somehow is deemed to justify its failure and refusal to take similar action in *this* area (FPC Br., pp. 9-10 and p. 13 fn. 25; Hope Br., pp. 23-24; Prod. Br. p. 9). The issue of the propriety or legality of the price-conditioning levels selected in those proceedings is, of course, entirely outside the scope of this case. But regardless of the propriety or legality of those recent producer certificate determinations in *other* producing areas, it is undisputed that in *this*, southern Louisiana, producing

area—the most important and prolific in the nation and the source of both the Catco and Transco-Seaboard gas—no initial price condition of *any* kind has yet been imposed, for *any* proposed producer sale, at *any* proposed initial price level. Moreover the Commission has given explicit assurance to the producers that none will be imposed, except—perhaps—at proposed initial price levels above and beyond 24.05¢ per Mcf (PSC Br. p. 29 and fn. 31; cf. FPC Br. p. 10).

In a similarly curious analogy, FPC and the Hope-intervenors note that the Commission embarked upon regulation of producers under the Natural Gas Act at their unregulated price levels in effect on the day of the *Phillips* decision.⁷ This precedent, they suggest, supports the Commission's present determination (or promise) to initiate its regulation of producer initial prices under Section 7 of that Act at the maximum unregulated prices in effect on a date *five years after Phillips* directed its assumption of producer regulatory jurisdiction (FPC Br. p. 12, fn. 20; Hope Br. p. 24). While petitioner does not object to a *June 7, 1954* starting date for any producer regulatory purpose, we do oppose most emphatically the notion that *Catco*, *Phillips* or any other pertinent opinion of the Supreme Court authorizes or permits respondent to perpetuate, to proliferate and to standardize as an initial price floor for the future, the maximum unregulated producer price it erroneously permitted to be exacted in southern Louisiana on *June 22, 1959*.

The respondents' argument that this policy would not "nullify" the Supreme Court's *Catco* opinion is, we submit, utterly preposterous. We would inquire, rhetorically, what conceivable purpose could be served, or ever could have been served, by the *Catco* remand if respondent was permitted, on August 10, to *exempt* the instant *Catco* successors from the very conditioning or evidentiary requirements the Supreme Court had imposed upon *Catco* itself on June 22? What conceivable reason exists, or ever could have existed, for demanding additional proof to support

⁷ *Phillips Petroleum Co. v. Wisconsin*, 347 U. S. 672 (June 7, 1954).

Catco's prices if initial prices even higher might simultaneously be regarded by respondent as "in line" and subject to no more than the same minimal evidentiary standard held inadequate to support Catco's unconditional certification? These questions, we submit, answer themselves. It is perfectly clear that the Supreme Court did not confer upon respondent, tacitly, impliedly or at all, "discretion" to continue issuing unconditional producer certifications, as it did in this proceeding, at higher-than-Catco initial price levels upon deficient-as-Catco record justification therefor.

Moreover, respondent itself did not come up with its present thesis to the contrary until August 10, 1959. This was six weeks after the Supreme Court's *Catco* decision but, significantly, only six days after the perfect foundation for that thesis had been laid by the Third Circuit's erroneous *Transco-Seaboard* decision.

POINT II.

Respondent's issuance of the instant certificates was based wholly upon the Third Circuit's incorrect interpretation of *Catco*.⁸

On August 4, the Third Circuit affirmed the Commission's unconditional certification, upon a Catco-type deficient record, of 22.4¢ to 23.3¢ initial prices. Under *Catco*, said that Court, price was still only an element to be "considered" by the Commission in its "weighing of all factors"—unless the price was "out of line", in which event only, would a price reducing condition or proof of price propriety be required to permit certification. There, neither was required because the prices, being similar to many other post-Catco prices, were not "out of line" and could, therefore, lawfully be exempted from the Supreme Court's *Catco*-imposed conditioning or evidentiary requirements.

⁸ *United Gas Improvement Co. v. Federal Power Comm'n*, 269 F. 2d 865 (3rd Cir., August 4, 1959).

This decision, unlike the Supreme Court's, was one the Commission could accept with relief, enthusiasm and alacrity. It promptly did so. Six days later it unconditionally certificated five groups of sales (including the present ones), again at higher-than-Catco prices, again upon deficient-as-Catco evidentiary records. In each, respondent solemnly professed "consideration" of prices and adherence to the principles of the *Catco* opinion, exactly as did the Third Circuit on August 4. Yet, in spite of all these professions of devotion to *Catco*, it took the occasion on that date, in the determination here on review, to advise the consuming public—and the gas producers—that it would *not* require the "conclusive proof" of public convenience and necessity, demanded by the Supreme Court in respect of 22.4¢ initial prices, *for any initial prices up to and including 24.05¢ per Mcf!*

On October 9, 1959 (two days after the denial of rehearing in this case) PSC petitioned the Supreme Court for certiorari in the *Transco-Seaboard* case. We urged that the Third Circuit's principal ground for *affirming* FPC's unconditional certifications in that case—i.e., that Catco and its successors had already elevated initial prices to an "in line" level of 23 or 24¢ per Mcf—*should be the principal reason for setting aside* those certificates and for remanding the *Transco-Seaboard* proceeding to respondent for the same disposition that had been ordered in *Catco*—i.e., imposition of initial price reducing conditions *or* insistence upon adequate evidentiary support for the proposed prices *per se*. Otherwise—if Catco's successors were to be deemed "in line" and exempt from the evidentiary requirements imposed on Catco itself—not only would the *Catco holding* be subverted (because 22.4¢ prices would then also be "in line" and summarily certifiable on remand upon the same minimal showing found inadequate to sustain their unconditional certification in the first place), but the Court's *Catco reasoning* would be deprived of its whole point, meaning, purpose and sense.

On the other hand, respondent and its producer associates, in some 103 pages of briefs in the *Transco-Seaboard*

proceeding, urged upon the Supreme Court the *very same* thesis now presented to this Court; i.e., that the *Catco* opinion still left FPC "discretion" to issue producer certificates at *Catco*-plus initial prices (which, it claimed, were no longer "out of line") without either initial price reducing conditions or evidentiary support for the propriety of such initial price levels (other than familiar assurances of arm's-length negotiation and the ability of the purchaser to sell more gas, etc.). Volubly protesting its firm and undeviating allegiance to the principles of the *Catco* opinion (as the Commission then and now still views them) FPC urged the Supreme Court to *deny certiorari*. Since the Commission professed obedience to the teachings of *Catco*, *citing its instant determination to demonstrate that obedience*, there was obviously no need, it was claimed, for that Court to speak again, and so soon, on the subject of producer initial pricing.

In reply, PSC said:

"With the latter portion of the FPC's presentation we are in total accord. There is no need for this Court to re-state its lucid *Catco* dissertation upon respondent's duties and obligations under Section 7 of the Natural Gas Act. There is, however, an obvious vital need for this Court to act upon the instant petitions in such a way as to preserve the integrity of this Court's June 22, 1959 pronouncement upon the subject. This may be accomplished by grant of the applications and summary reversal of the judgment below, upon the cited authority of *Atlantic Refining Co., et al. v. Public Service Commission of the State of New York*, 360 U. S. 378. This, on behalf of the millions of gas consumers we represent, we respectfully urge."⁹

⁹ Brief for Petitioner Public Service Commission in Reply, No. 459, October Term, 1959, at p. 16.

POINT III.

Respondent's issuance of the instant certificates is in conflict with, and subversive of, the Supreme Court's *Transco-Seaboard* decision.¹⁰

PSC respectfully submits that this unusual and extraordinary relief was granted, in full and as requested, by the Supreme Court's summary disposition of December 14, 1959.

Respondents, on the other hand, can detect in that decision only

(1) another Supreme Court refusal to direct the initial price "roll back" allegedly demanded by the petitioner for the second time—a demand petitioner most certainly did not make, even once, and an issue that is totally spurious and has not the remotest connection with that case; and

(2) affirmance of the dissenting opinion of Third Circuit Judge Hastie, who would have remanded *Transco-Seaboard* in order to ascertain "whether the Commission would have proceeded as it did and reached the result it reached here, had the subsequent teaching of the *Atlantic Refining Company* case then been before it". (FPC Br., p. 17-18, Hope Br., pp. 24-28, Prod. Br., pp. 20-21).

In support of the latter contention, respondents rely on the *Barenblatt* case¹¹ and a line of similar decisions. For reasons that are perfectly obvious, they do not mention the highly salient and distinguishing fact that when Judge Hastie spoke in *Transco-Seaboard* and when the Supreme Court spoke in *Barenblatt* and analogous cases, there really

¹⁰ *Pub. Serv. Comm'n of N. Y. v. F. P. C.*, 361 U. S. 195 (December 14, 1959).

¹¹ *Barenblatt v. United States*, 354 U. S. 930.

was an unresolved question as to whether the lower tribunal would have acted as it did had the subsequently rendered teaching of the Supreme Court been before it. When the Supreme Court spoke in *Transco-Seaboard*, on the contrary, no such uncertainty existed at all.

On December 14, 1959 affirmance of Judge Hastie's August 4 dissent would have been nothing but an exercise in futility. Petitioner is not eager to assume, as, apparently, are the respondents, that the Supreme Court was persuaded, over the objections of both petitioner PSC and respondent FPC, to engage in that kind of fruitless and pointless activity.

In the *Transco-Seaboard* appeal, briefs had been submitted and oral argument to the Third Circuit had been concluded before June 22, 1959. After the issuance of the *Catco* opinion on that date, various intervenors submitted supplementary briefs to the Third Circuit "interpreting" the Supreme Court's decision. Respondent FPC did not submit a supplementary brief. Neither did it issue any producer certificate decisions during the June 22 to August 10 interval, which might have shed some light on its understanding of *Catco*. Therefore, on August 4, when Judge Hastie advocated a remand of *Transco-Seaboard* to ascertain the Commission's response to *Catco*, the Commission's response to *Catco* actually was unknown to the Third Circuit or to anyone else.

In like manner, when the *Barenblatt* case was before the Supreme Court, the response of this Court to the subsequently issued *Watkins* decision¹² also was unknown. Remand was the logical, purposeful and, in fact, only method of ascertaining whether or not this Court would have decided *Barenblatt* the same way in the light of *Watkins*.

When the *Transco-Seaboard* proceeding reached the Supreme Court, however, FPC (unlike this Court in *Barenblatt*) was an active participant—in fact, the respondent—in the case. Its very act of *opposing* the petitions for cer-

¹² *Watkins v. United States*, 354 U. S. 178.

tiorari and *defending* the Court of Appeals decision told the Supreme Court that the Third Circuit had anticipated its response to *Catco* correctly; that the Commission *would* (unless deterred) reach the same decision in Transco-Seaboard with the *Catco* opinion before it. If any doubt then remained, the Supreme Court was fully apprized, by the Commission itself, of its present "reaction" to *Catco*. The Commission explained and illustrated that reaction in detail, in its brief opposing the writ, *by citing and summarizing its determination herein and in its other August 10 certificate orders pertaining to southern Louisiana fields—all granting unconditional authorization for initial prices almost equal to or actually in excess of Transco-Seaboard's, after and upon full FPC "consideration" of the Catco opinion.*

Were respondent's reaction to *Catco*, as explained by it to the Supreme Court, reasonable or even permissible under the holding of that case, it is perfectly clear that the Third Circuit's failure to remand *Transco-Seaboard* would have been—if error at all—harmless, immaterial and of no consequence. It would scarcely have merited the grant of certiorari, much less warranted summary remand of the *Transco-Seaboard* proceeding. In *this* (the actual) context of that decision, respondents' unanimous assertions that the Supreme Court's grant of the writ and order of remand have no "substantive" bearing or "adverse effect" upon the "merits" of the Commission's thesis, or the validity of the present determination, are, we submit, if not effrontery, sheer refusal to face the facts.

POINT IV.

Respondent's issuance of the instant certificates will result in increased natural gas costs.

Respondents would have this Court believe that the instant natural gas purchase by a member of the Consolidated System at a price more than 7¢ above the System's

current average price for similar gas acquisitions will not result in increased costs of purchased gas (FPC Br., pp. 18-19, Hope Br., pp. 17-19, Prod. Br., p. 5). Much as petitioner would like to believe in miracles, this one, we fear, is engendered only by courtesy of intercompany bookkeeping. Obviously it has no place in the hard and inexorable world of economic reality.

According to Hope's own witness, the Consolidated System's average cost of southwestern-produced pipeline-purchased gas is approximately 37.5¢ per Mcf (R. 1558-59).¹³ According to Hope's own exhibit, about 80 per cent of the System's pipeline purchases (totalling 426,901,000 Mcf per annum) are now delivered by the sellers, fully "processed" and at 37.5¢ per Mcf, to the very member companies which will receive the gas involved in this proceeding (R. 3258, Exh. 13, p. 40). The *only* difference between the gas they now receive and the gas they will receive as a result of the unconditional certification below, is the difference of more than 7¢ per Mcf in its cost to the parent System.

The other 20 per cent of the System's pipeline purchases are delivered to Hope. A portion of this 20 per cent is resold by Hope to non-affiliates (R. 1179). The balance is resold by Hope to its affiliates at the 48.19¢ and 50.63¢ per Mcf prices set forth at page 18, footnote 18 of Hope's brief. It is only with respect to this latter portion that Hope incurs the additional costs, above the "raw" purchase price of 37.5¢ per Mcf, for storage and other processing services (Hope Br., pp. 5, 18-19).

Petitioner is strongly inclined to agree with respondent's FPC's insinuation that Hope has absolutely no business charging its affiliates (and through them, the ultimate gas consumer) 48.19¢ and 50.63¢ per Mcf prices for the present supplies, which Hope will never see, which will never be delivered to Hope and as to which Hope will incur no additional costs, for storage or other processing services, above the instant "raw" purchase cost to the System of 44.825¢ per Mcf (FPC Br., pp. 4-5). That Hope proposes to do so,

¹³ Hope's individual average cost is slightly lower than the total System average (R. 1559).

however, certainly cannot alter, and should not be permitted to obscure, the simple and inescapable fact that a gas purchase at 44.825¢ per Mcf by a member of a System formerly paying 37.5¢ for the very same commodity, in the very same condition, at the very same delivery points, does and must increase System purchased gas costs. Increased gas costs, we repeat, have always led to increased gas rates. Hope's extremely ambiguous discussion of the cost impact of the instant purchases on the Consolidated System does not encourage petitioner to anticipate a different result in this proceeding.

Conclusion.

For the foregoing reasons and the reasons stated in petitioner's earlier brief, dated April 15, 1960, this case should be disposed of as requested therein.

Respectfully submitted,

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